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IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

THE SOUTHLAND CORPORATION, *et al.*,

Appellants,

—v.—

RICHARD D. KEATING, *et al.*,

Appellees.

ON APPEAL FROM THE SUPREME COURT OF CALIFORNIA

JURISDICTIONAL STATEMENT

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September 1982

QUESTIONS PRESENTED

1. Whether the federally protected right of arbitration under the Federal Arbitration Act is unlawfully impaired when a state court superimposes judicial class action procedures (including court-supervised discovery, briefing, certification, notice and opt-out procedures, mandatory preparation of transcripts, and ongoing judicial control) on a private arbitration of a commercial dispute involving interstate commerce.

2. Whether a state statute violates the Supremacy Clause of the United States Constitution when it invalidates arbitration agreements involving interstate commerce that are "valid, irrevocable, and enforceable" under the terms of the Federal Arbitration Act.

PARTIES BELOW

This appeal involves eight cases that were consolidated in the court below.* Plaintiffs, who are former franchised operators of 7-Eleven® convenience stores in the State of California, are Richard and Darla Keating, Edward and Betty Gouveia, Harry Battersby, Patrick and Cathy Cheng, Michael and Gloria Coy, Phillip and Joan Newell, Thomas and Wanda Sampson, and Arthur and Jenny Scovis. Some of the plaintiffs purport to represent a class consisting of all current and former 7-Eleven franchisees in California.

Defendants are The Southland Corporation, which owns the 7-Eleven® service mark, and several of its current and former officers, directors and employees: John P. Thompson, Jere W. Thompson, Walton Grayson, III, Joseph S. Hardin, R.G.

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* One additional case, *Garza* v. *Southland*, was originally consolidated with the others but has since been settled.

Smith, Eugene Pender, S.R. Dole, Terry De Bard, Gene Janssen, Curtis Pare, Ray Berry, Paul Stevenson, Michael Wildman, Robert Johnson, Ernest Arzabal, Michael Drury, Keith Jenkins, Robert Duncan, Fred Elwood, Joseph Galea, Dave Pava, Tal Colson and Douglas Porter.

Defendant The Southland Corporation has no parent corporation, subsidiaries (except wholly owned subsidiaries), or affiliates.

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Appellants,

—v.—

RICHARD D. KEATING, *et al.*,

Appellees.

ON APPEAL FROM THE SUPREME COURT OF CALIFORNIA

JURISDICTIONAL STATEMENT

Appellants, The Southland Corporation and several of its current and former officers, directors and employees (hereinafter collectively referred to as "Southland"), appeal from a final judgment of the Supreme Court of California.

OPINIONS BELOW

The majority and dissenting opinions of the California Supreme Court are reported at 31 Cal. 3d 584, 183 Cal. Rptr. 360, 645 P.2d 1192 (1982), and are reprinted in the separate Appendix to this Jurisdictional Statement at 1a-45a (hereinafter "App."). The opinion of the California Court of Appeal, First Appellate District, is reported at 109 Cal. App. 3d 784, 167 Cal. Rptr. 481 (1980), and is reprinted at App. 47a-70a. The orders of the Superior Court of Alameda County (App. 71a-80a) are unreported.

JURISDICTION

The judgment of the Supreme Court of California was entered on June 10, 1982. Southland filed a timely notice of appeal in that court on August 24, 1982. (App. 83a-84a.) Upon timely application, Justice Rehnquist granted Southland an extension of time until September 22, 1982 to docket an appeal or, in the alternative, to file a petition for a writ of certiorari. (App. 85a.) The jurisdiction of this Court is conferred by 28 U.S.C. § 1257(2) (1976), because the California Supreme Court has sustained the validity of the California Franchise Investment Law and California class action rules notwithstanding Southland's contention that such statute and rules, as construed, violate the Constitution and laws of the United States.

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

The following constitutional provisions and statutes are involved in this appeal and are set forth in the separate Appendix to this Jurisdictional Statement (App. 87a-88a): the Supremacy Clause of the United States Constitution (art. VI, cl. 2); the Due Process Clause of the Fourteenth Amendment to the Constitution; Sections 1-3 of the Federal Arbitration Act, 9 U.S.C. §§ 1-3 (1976); and Section 31512 of the California Franchise Investment Law, CAL. CORP. CODE § 31512 (West 1977).

STATEMENT OF THE CASE

This appeal involves an unprecedented decision of the California Supreme Court, holding that individual franchisees, who agreed to arbitrate any disputes arising under their interstate franchise agreement, could file a judicial action, asking the court to direct their arbitration claim to proceed on a "class action" basis. The court rejected Southland's argument that

this state-imposed, judicial procedure would violate the Supremacy Clause of the United States Constitution by impairing the exercise of substantive rights protected by the Federal Arbitration Act, title 9, U.S.C. (1976), and would violate the Due Process Clause of the Fourteenth Amendment unless the court exercised strict control over the arbitration.

This appeal also concerns the California Supreme Court's holding that the California Franchise Investment Law, CAL. CORP. CODE §§ 31000-31516 (West 1977), preempts the Federal Arbitration Act and renders arbitration agreements unenforceable with respect to claims brought by franchisees against franchisors under that statute. The court rejected Southland's argument that the Federal Arbitration Act preempts anti-arbitration statutes such as the California franchising statute. The decision of the California Supreme Court on both the class action issue and the preemption issue is in conflict with decisions of other state and federal courts and has widespread implications affecting the viability of arbitration throughout the country.

This litigation began in May 1977 with the filing of an action by Richard and Darla Keating in the Superior Court for Santa Clara County, California. Plaintiffs were franchised operators of a 7-Eleven convenience store. They alleged that their franchisor, Southland, had utilized an accounting system in preparing financial statements for their store that was unfair and inaccurate and that representatives of Southland had made certain fraudulent representations concerning the accounting system. Southland's conduct was alleged to give rise to several related causes of action, including common law fraud, breach of contract, breach of fiduciary duty and a violation of the California Franchise Investment Law.[1] Plaintiffs purported to

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1 The California Franchise Investment Law requires franchisors to make certain disclosures to prospective franchisees, and prohibits franchisors from making fraudulent or misleading statements to those prospective franchisees. In essence, it establishes a specific statutory cause of action for certain fraudulent conduct. Plaintiffs' claim under this statute is based on the same facts as, and is largely duplicative of, plaintiffs' various common law causes of action.

represent a class of all current and former 7-Eleven franchisees in California.[2] Thereafter, similar complaints were filed by the other appellees herein, and the actions were consolidated for pretrial proceedings in the Superior Court for Alameda County.[3]

Pursuant to an arbitration clause in plaintiffs' franchise agreements, which provided that the parties would arbitrate "any controversy or claim arising out of or relating to this Agreement or the breach hereof . . . in accordance with the Rules of the American Arbitration Association . . . ," Southland moved to compel arbitration in each of the cases. Plaintiffs argued, among other things, that their claims based on the California Franchise Investment Law were nonarbitrable.[4] Southland responded that if the state statute were interpreted as plaintiffs urged to contain an anti-arbitration policy, then it would be contrary to the Federal Arbitration Act and invalid under the Supremacy Clause of the United States Constitution.

As a fallback position, plaintiffs suggested that if their claims were arbitrable, the court should create a procedure whereby the arbitration would be conducted as a class action. Plaintiffs did not seriously pursue this issue in the Superior Court.

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2 Plaintiffs' original complaint alleged a class consisting of all current and former 7-Eleven franchisees in the United States, but the scope of the purported class was narrowed to California franchisees in an amended complaint filed in December 1977. Plaintiffs alleged that there were about 800 persons in this narrowed class.

3 Some of the consolidated cases were commenced prior to the *Keating* case. However, after *Keating* had been filed, amended complaints were filed in these cases to conform their allegations to those of the newly-filed complaint in *Keating*. These amended pleadings substantially changed the focus of those earlier cases. *See* App. 21a-22a.

4 Plaintiffs also contended that Southland had waived its right to arbitrate and that the agreements were unenforceable adhesion contracts. However, the California Supreme Court rejected these arguments on the basis of the law and the facts. (App. 5a-8a, 19a-23a.) The "waiver" and "adhesion contract" issues are not involved in this appeal.

The Superior Court held that plaintiffs were required to arbitrate their claims of common law fraud, breach of contract and breach of fiduciary duty, but not their claims under the Franchise Investment Law. (*See* App. 72a, 74a, 79a.)[5] The court did not reach the issue whether the arbitration should proceed as a class action.

The California Court of Appeal rejected plaintiffs' argument that the Franchise Investment Law contains an anti-arbitration policy. (App. 66a-68a.) It further concluded that if the statute were so interpreted, it would be invalid with respect to contracts involving interstate commerce, because the Federal Arbitration Act provides that such arbitration agreements are "valid, irrevocable, and enforceable." (App. 68a-70a.) The court therefore held that the Franchise Investment Law claims were arbitrable along with the remainder of plaintiffs' causes of action. (App. 70a.) The Court of Appeal also ruled, however, that there is no "insurmountable obstacle" to conducting an arbitration on a class-wide basis (App. 63a), and it remanded the cases to the trial court for class certification proceedings, since such proceedings could not constitutionally be conducted by an arbitral tribunal. (App. 64a.)

The California Supreme Court, by a divided vote of 4-2, ruled on both of these issues. First, it reversed the Court of Appeal's ruling that claims asserted under the California Franchise Investment Law are arbitrable. The court concluded that the California legislature intended to render arbitration agreements unenforceable with respect to claims based on that

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5 The Superior Court's orders did not explain the reasons for denying arbitration of the Franchise Investment Law claims. However, the trial judge later explained on the record (i) that in his view the arbitration clause in the 7-Eleven franchise agreement was not broad enough to include these claims, and (ii) that he therefore had not reached plaintiffs' argument that Franchise Investment Law claims were nonarbitrable. Transcript of Hearing of July 19, 1978, at 20-24, *Market Franchise Cases*, Cal. Jud. Council Coord. No. 387 (Cal. Super. Ct., Alameda Co.). The Superior Court's narrow construction of the contract was reversed by the California Court of Appeal (App. 65a-66a), and that ruling was not disturbed by the California Supreme Court.

statute. It held further that anti-arbitration statutes of this kind do not contravene the federal substantive law embodied in the Federal Arbitration Act. (App. 8a-18a.)

Second, the California Supreme Court affirmed the Court of Appeal's ruling on the availability of a class action arbitration procedure. (App. 23a-30a.) It stated that California public policy favors class actions and that, in some cases, this procedure might be fairer than an individual arbitration. It therefore held that a class action arbitration could be imposed on the parties without their mutual consent. The majority did not directly address Southland's argument that this pro-class action policy is overridden, at least with respect to interstate contracts such as those at issue here, by the federal statutory policy favoring simple, quick, inexpensive and nonjudicial arbitrations. The court acknowledged, however, that a judicially ordered classwide arbitration "would entail a greater degree of judicial involvement than is normally associated with arbitration," including "a measure" of ongoing judicial supervision "in order to safeguard the rights of absent class members to adequate representation and in the event of dismissal or settlement." (App. 28a-29a.) The court contemplated that the trial court would authorize discovery and briefing on the class action issue; determine whether a class action was appropriate; supervise any notice and opt-out procedures; oversee the arbitration proceedings themselves to ensure that the interests of the class were being adequately represented by the named claimants and adequately protected by the arbitrators; and review any decision to dismiss or settle the dispute. (*See* App. 29a.) The majority recognized that the trial court would necessarily walk a thin and sensitive line between adequate supervision and inappropriate intrusion: It observed that the trial court would need to use "a good deal of care, and ingenuity" in order to supervise the arbitration proceedings in these ways while "avoid[ing] judicial intrusion upon the merits" and "minimiz[ing] complexity, costs, or delay." (App. 29a.)

The dissenting justices in the California Supreme Court (Richardson and Mosk, JJ.) disagreed with both rulings. First,

with respect to the California Franchise Investment Law issue, they referred to the long line of authority establishing that the Federal Arbitration Act creates a body of federal substantive law that supersedes any anti-arbitration policies at the state level with respect to interstate arbitration agreements. (App. 32a-34a.) They disagreed with the majority's view that the states are free to carve out exceptions to the coverage of the federal statute, and concluded that the majority opinion's "chances of surviving federal review are very dubious." (App. 37a.)

Second, the dissenting justices found that class action arbitrations would be "fundamentally contrary to the purpose of arbitration and to the public policy encouraging arbitration." (App. 44a.) The dissenters noted the absence of statutory or precedential authority for the procedure; catalogued ways in which courts inevitably would supervise and review arbitrators' actions; and then concluded that the majority's newly-fashioned procedure "would tend to make arbitration inefficient instead of efficient, lengthy instead of expeditious, and procedural instead of informal." (App. 41a.)

THE QUESTIONS ARE SUBSTANTIAL

The decision of the California Supreme Court constitutes a substantial threat to the efficacy and viability of private arbitration as an alternative to judicial proceedings. The decision seeks to establish the right of state legislatures to enact statutes restricting the coverage of the Federal Arbitration Act, and, with respect to other, arbitrable claims, it encumbers and eviscerates arbitration by imposing precisely the kinds of judicial procedures that arbitration was designed to avoid.

The California court's decision on the class action issue is unprecedented. No state or federal court has ever previously suggested that it would be proper to engraft class action procedures—and the close judicial supervision that necessarily comes with those procedures—onto private arbitration proceedings.

The California court's decision on the Franchise Investment Law issue improperly attempts to preempt federal substantive law relating to interstate commerce and is in conflict with numerous rulings by other federal and state courts. These courts have held that interstate arbitration contracts are governed by the Federal Arbitration Act, which provides that arbitration agreements shall be "valid, irrevocable, and enforceable . . . ."

Unless it is overturned by this Court, the California Supreme Court's decision will promote forum shopping and will restrict the arbitrability of claims both within and outside of California. Moreover, the outcome of this case will determine whether state legislatures and courts are free to adopt statutes and policies overriding the Federal Arbitration Act.

The Federal Arbitration Act was enacted in 1925 for the specific purposes of (i) providing an alternative to lengthy, expensive, formalized court actions and (ii) overruling state anti-arbitration policies where interstate commerce is involved.[6] These policies are even more important today than they were then. The judicial system has become burdened with an increasingly heavy workload, and lawsuits have become more costly, protracted and complex than they were in 1925.[7] It

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6 H.R. REP. NO. 96, 68th Cong., 1st Sess. 1-2 (1924); *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506, 510-11 (1974); *Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404 (1967). *See* S. REP. NO. 536, 68th Cong., 1st Sess. 2-3 (1924); *Arbitration of Interstate Commercial Disputes: Joint Hearings on S. 1005 and H.R. 646 Before the Subcomms. of the Comms. on the Judiciary*, 68th Cong., 1st Sess. 34-35 (1924) (brief submitted by American Bar Association).

7 From 1940 to 1981, annual federal district court civil case filings increased from approximately 35,000 to 180,000. Federal civil cases increased almost six times as fast as population, and despite a significant increase in the number of federal district court judges, the yearly civil filings per judgeship almost doubled between 1940 and 1981, from approximately 180 to 350 cases. Class action cases are responsible for a significant degree of the burdens imposed upon judges. *See* ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS, 1981 ANNUAL REPORT OF THE DIRECTOR 3-4, 56-59, 82-83 (Prelim. ed. 1981); ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS, 1980 ANNUAL REPORT OF THE DIRECTOR 2-4,

is therefore of the utmost importance for this Court to prevent the erosion of arbitration as a meaningful alternative to the judicial method of dispute resolution.

A. The Viability of Arbitration Under the Federal Arbitration Act Depends on Its Freedom from the Strict Judicial Controls and Procedures Required by the Decision Below.

1. *Arbitration Is a Highly Favored Alternative to Litigation in the Courts.*

Arbitration is a contractual method of dispute resolution that is intended to take place outside the judicial system, without interference by the courts and without adherence to conventional judicial procedures. By choosing arbitration, parties elect to have one or more nonjudicial umpires of their choosing, often experts in the subject matter of the dispute, hold an informal, prompt hearing and reach a fair decision. The arbitrators need not be lawyers, for the process they administer is not legalistic. They enjoy wide latitude in conducting the proceedings. Judicial procedures—such as pretrial discovery, the rules of evidence, the right to appeal, a written transcript, and the necessity of rendering carefully articulated written decisions—are not applicable. Parties frequently conclude that lawyers are unnecessary in this informal setting. Moreover, arbitrators, unlike courts, need not consider the impact of their decisions as precedent that may be applicable to nonparties to the controversy. Arbitration thereby facilitates prompt decisions and discourages parties from overlitigating a dispute because of concerns that an adverse decision may extend beyond the particular facts at issue.[8]

54-58 (1980); Burger, *Isn't There a Better Way*, 68 A.B.A.J. 274, 275 (1982) (address to ABA). *See also* Kirkham, *Problems of Complex Civil Litigation*, 83 F.R.D. 497, 499-501 (1979) (congestion in courts). The congestion is not confined to the federal courts. *See, e.g., Judicial Conference for the District of Columbia Circuit*, 89 F.R.D. 169, 175 (1980) (remarks of Burger, C.J.).

[8] *See, e.g., Bernhardt* v. *Polygraphic Co. of America*, 350 U.S. 198, 203 & n.4 (1956); *United Steelworkers* v. *Enterprise Wheel & Car*

When Congress enacted the Federal Arbitration Act, it sought to protect the right of parties to interstate contracts to elect arbitration as an alternative to judicial litigation. Prior to the Act, courts in a number of states had held arbitration to be contrary to public policy, so Congress expressly provided, in Section 2 of the statute, that interstate arbitration agreements are "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. The courts have uniformly held that the Act establishes a strong federal policy favoring arbitration and that this procedure should be protected from any efforts to dilute its effectiveness.[9] Thus, under the Supremacy Clause of the Constitution (art. VI, cl. 2), the states cannot apply their own statutes and rules to interstate arbitration agreements if those policies would constitute "an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *E.g., Chicago & N.W. Transp. Co.* v. *Kalo Brick & Tile Co.*, 450 U.S. 311, 317 (1981). *See also* cases cited *infra* at 25-26.

The strong federal policy favoring arbitration was recently reiterated by Congress in enacting the patent and trademark appropriations bill for 1983-85. Pub. L. No. 97-247 (1982). Congress included a provision in that statute which overrules judicial decisions holding that disputes concerning patent validity or infringement are nonarbitrable. *Id.* § 17(b). In explaining the purpose of this provision, the House Report

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Corp., 363 U.S. 593, 598 (1960). For a discussion of the informality of arbitration and its differences from judicial litigation, *see generally* A. Widiss, Arbitration: Commercial Disputes, Insurance, and Tort Claims 6-7, 339 (PLI 1979); Domke on Commercial Arbitration § 24.02 at 235-39, § 24.07 at 252, § 25.01 at 255-56, § 26.01 at 265-66, § 27.01 at 271-72, § 29.06 at 286-89, and pp. 312-13 (1968); Rehnquist, *A Jurist's View of Arbitration*, 32 Arb. J. 1, 5-7 (1977); Brown, *Some Practical Thoughts on Arbitration*, 6 Litigation 8, 8-10 (Winter 1980).

9 *See, e.g., Robert Lawrence Co.* v. *Devonshire Fabrics, Inc.*, 271 F.2d 402, 406-07, 410 (2d Cir. 1959), *cert. dismissed*, 364 U.S. 801 (1960); *Galt* v. *Libbey-Owens-Ford Glass Co.*, 376 F.2d 711, 714 (7th Cir. 1967); *J.S. & H. Construction Co.* v. *Richmond County Hospital Authority*, 473 F.2d 212, 214-15 (5th Cir. 1973).

emphasized that arbitration benefits not only the parties to a particular dispute but also the public at large by reducing the burdens on the courts:

> The advantages of arbitration are many: it is usually cheaper and faster than litigation; it can have simpler procedural and evidentiary rules; it normally minimizes hostility and is less disruptive of ongoing and future business dealings among the parties; it is often more flexible in regard to scheduling of times and places of hearings and discovery devices; and, arbitrators are frequently better versed than judges and juries in the area of trade customs and the technologies involved in these disputes.
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> The enforcement of voluntary arbitration would serve the public in two ways. First, . . . [it] will enhance the patent system . . . . Secondly, arbitration could relieve some of the burdens on the overworked Federal courts. Chief Justice Burger in his speech to the American Bar Association on January 24, 1982, generally endorsed the use of arbitration to reduce the judicial backlog.[10]

2. *The Essence of Arbitration Is Its Avoidance of Judicial Procedures; Class Actions Require Active Judicial Involvement.*

Waiver of judicial procedures goes to the heart of arbitration. Arbitration "isn't 'just like the courts.' In fact, its strongest points lie in those areas where it most widely differs from the courts." DOMKE ON COMMERCIAL ARBITRATION § 1.01, at 2. Thus, it has repeatedly been held that arbitration should not be encumbered with procedures that might delay or complicate the proceedings, or require judicial intervention when the arbitration is in progress.[11] As Judge Learned Hand

10 H.R. Rep. No. 542, 97th Cong., 2d Sess. 13 (1982). *See also Report of the Pound Conference Follow-Up Task Force*, 74 F.R.D. 159, 166, 169, 179-81 (1976) (discussing the advantages of arbitration and recommending its increased use).

11 *See, e.g., Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*, 388 U.S. at 404; *Cavanaugh* v. *McDonnell & Co.*, 357 Mass. 452, 457, 258

stated in *American Almond Products Co.* v. *Consolidated Pecan Sales Co.*, 144 F.2d 448, 451 (2d Cir. 1944):

> Arbitration may or may not be a desirable substitute for trials in courts; as to that the parties must decide in each instance. But when they have adopted it, they must be content with its informalities; they may not hedge it about with those procedural limitations which it is precisely its purpose to avoid.

The court below has done precisely that. It has imposed a *judicial* mechanism which is radically different than the informal procedure agreed to by the parties, and which has a profound impact on the scope, costs, risks and procedures of the litigation. Indeed, class actions are the paradigm example of large, time-consuming, rigorously-regulated, difficult-to-manage judicial procedures.

Class actions require a much greater degree of judicial supervision, and more rigid adherence to formalities, than other court proceedings. Because they bind the rights of persons who have not sued and who do not control the lawsuit, class actions pose delicate constitutional issues. They satisfy due process standards only if and to the extent that the named plaintiff's claim is typical of those of other class members, the best practicable notice is given to the class, and the named plaintiff and his counsel fully and adequately protect the interests of the class.[12]

In a class action, absent class members cannot constitutionally be bound by the result of the proceeding unless there has been careful and active judicial participation in virtually all aspects of the litigation. For example, discovery, briefing and a

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N.E.2d 561, 564 (1970); *De Sapio* v. *Kohlmeyer*, 35 N.Y.2d 402, 406, 362 N.Y.S.2d 843, 847, 321 N.E.2d 770, 773 (1974).

12 *See Hansberry* v. *Lee*, 311 U.S. 32, 42-43, 45 (1940); *Sam Fox Publishing Co.* v. *United States*, 366 U.S. 683, 691 (1961); *H.L.* v. *Matheson*, 450 U.S. 398, 432 n.9 (1981) (Marshall, J., dissenting); *Robertson* v. *National Basketball Ass'n*, 556 F.2d 682, 685-86 (2d Cir. 1977); *Gonzales* v. *Cassidy*, 474 F.2d 67, 74 (5th Cir. 1973).

hearing are usually required before the court decides whether to certify a class.[13] The court must carefully define the class, determine the best practicable form of notice to the class, and approve the content of the notice;[14] and class members must be allowed to opt out of the litigation.[15] After completion of these preliminary proceedings, which normally consume many months,[16] the court must continue to supervise all phases of the litigation to ensure that plaintiff's case is based on evidence common to the class, that plaintiff's interests are compatible with those of the class, and that plaintiff is a vigorous, effective and adequate class representative.[17] If, at *any* time, the initial class certification appears to have been erroneous, the class must be realigned or decertified.[18] If plaintiff's claims

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13 *See General Telephone Co.* v. *Falcon*, 102 S. Ct. 2364, 2372 (1982) (often necessary to "probe behind the pleadings" to decide class issues); *Coopers & Lybrand* v. *Livesay*, 437 U.S. 463, 469 & n.12 (1978) (class issues usually " 'enmeshed in the factual and legal issues comprising the plaintiff's cause of action' "); *Alabama* v. *Blue Bird Body Co.*, 573 F.2d 309, 312, 322-24 (5th Cir. 1978); *Belcher* v. *Bassett Furniture Industries, Inc.*, 588 F.2d 904, 906 (4th Cir. 1978).

14 *Oppenheimer Fund, Inc.* v. *Sanders*, 437 U.S. 340, 357 n.24 (1978); *Eisen* v. *Carlisle & Jacquelin*, 417 U.S. 156, 173-74 (1974).

15 FED. R. CIV. P. 23(c). *See also* the decision of the California Supreme Court at App. 28a.

16 Frequently, a year or more will be consumed in class action discovery, briefing and hearings alone. *See, e.g., In re Transit Co. Tire Antitrust Litigation*, 67 F.R.D. 59, 63, 72 (W.D. Mo. 1975); *Sommers* v. *Abraham Lincoln Federal Savings & Loan Ass'n*, 66 F.R.D. 581, 585 (E.D. Pa. 1975).

17 *E.g., In re Fine Paper Antitrust Litigation*, 617 F.2d 22, 27 (3d Cir. 1980); *Susman* v. *Lincoln American Corp.*, 561 F.2d 86, 89-90 (7th Cir. 1977); *National Ass'n of Regional Medical Programs, Inc.* v. *Mathews*, 551 F.2d 340, 344-46 (D.C. Cir. 1976), *cert. denied*, 431 U.S. 954 (1977).

18 *General Telephone Co.* v. *Falcon*, 102 S. Ct. at 2372; *Coopers & Lybrand* v. *Livesay*, 437 U.S. at 469 & n.11; *H.L.* v. *Matheson*, 450 U.S. at 432 n.11 (Marshall, J., dissenting); *Social Services Union, Local 535* v. *County of Santa Clara*, 609 F.2d 944, 948-49 (9th Cir. 1979); *Guerine* v. *J & W Investment, Inc.*, 544 F.2d 863, 864 (5th Cir. 1977).

are amended, or if other significant events occur, the court may require or authorize supplemental notices to the class.[19] If either the plaintiff or the defendant wishes to communicate with class members, the court may act to prevent misrepresentations or other abuses.[20] At trial, the court must ensure that plaintiff's evidence is "common," class-wide evidence.[21] After trial of the "common" issues, there may be hundreds of additional hearings on "individual" issues, such as damages.[22] Transcripts of the proceedings must be prepared, and the court must render written decisions, so that other courts can ascertain the scope of the class, the judgment, etc. After all issues of liability and damages have been resolved, a class member might seek to appeal from, or to avoid the res judicata effects of, the verdict by contending that the evidence was not "common" and/or that he was not adequately represented; if he was not, then the verdict cannot be binding on him.[23] In a class action, the parties cannot even settle their dispute without judicial review and approval: Due process requires that class members be given notice of the settlement, and if a class member objects, he must receive an opportunity for a hearing; the court must then determine whether the terms of the compromise are fair in view of the strengths and weaknesses of plaintiff's case, and other factors.[24] In short, class actions require intimate, ongoing judicial management at every stage.

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19 *See, e.g.*, FED. R. CIV. P. 23(d)(2); 7A C. WRIGHT & A. MILLER, FEDERAL PRACTICE & PROCEDURE § 1791 at 193-94, § 1793 at 201, 207-11 (1972).

20 *Gulf Oil Co.* v. *Bernard*, 452 U.S. 89, 100 (1981).

21 *See General Telephone Co.* v. *Falcon*, 102 S. Ct. at 2372.

22 *E.g., International Brotherhood of Teamsters* v. *United States*, 431 U.S. 324, 361 (1977); *EEOC* v. *Korn Industries, Inc.*, 662 F.2d 256, 260-61 (4th Cir. 1981); *Green* v. *Wolf Corp.*, 406 F.2d 291, 301 (2d Cir. 1968), *cert. denied*, 395 U.S. 977 (1969).

23 *E.g., Gonzales* v. *Cassidy*, 474 F.2d 67 (5th Cir. 1973).

24 *In re General Motors Corp. Engine Interchange Litigation*, 594 F.2d 1106, 1124 & n.21 (7th Cir.), *cert. denied*, 444 U.S. 870 (1979); *Mandujano* v. *Basic Vegetable Products, Inc.*, 541 F.2d 832, 835-36 (9th Cir. 1976); *Grunin* v. *International House of Pancakes*, 513 F.2d

The California Supreme Court recognized that these essential procedures, which arise from due process considerations, cannot properly be performed by arbitrators—who often are not even lawyers, much less judges. The California Supreme Court therefore acknowledged that in a purported class action arbitration *the court*, and not the arbitrators, would conduct the certification proceedings, monitor the adequacy of representation, review any proposed settlements, and so forth. (App. 28a-29a. *See also* the decision of the Court of Appeal at App. 64a.) The court below attempted to downplay the extent to which a judge would be involved but expressly conceded that the judiciary would be required to participate actively in several aspects of the litigation.[25]

3. *A Class Action Arbitration Would Destroy the Parties' Agreement To Arbitrate.*

It is difficult to imagine a procedure more alien to the spirit of arbitration. The procedure contemplated by the court below would seriously affect the viability of the rights guaranteed by the Federal Arbitration Act in many ways. For example:

— a procedure designed to operate outside the judicial system would require careful and continuous judicial participation;

— a mechanism intended to operate informally would be transformed into one involving detailed, legalistic procedures;

— a procedure designed to simplify the litigation would become more complex than if the litigation had re-

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114, 120-24 (8th Cir.), *cert. denied*, 423 U.S. 864 (1975); *Greenfield* v. *Villager Industries, Inc.*, 483 F.2d 824, 831-34 (3d Cir. 1973). *See also* FED. R. CIV. P. 23(e).

25 Even where the complications of a class action are not present, it is difficult for a court to play only a limited role in an arbitration. As one commentator has noted: "[O]nce a court gets into an arbitration proceeding, it has almost no way to get out of it. Pretrial discovery procedures require continual supervision." G. GOLDBERG, A LAWYER'S GUIDE TO COMMERCIAL ARBITRATION 41 (ALI-ABA 1977).

mained in court in the first place; the parties would litigate their dispute in two forums rather than one, and there would be substantial overlaps between the roles of the judge and arbitrator;

— a mechanism intended to be quick and inexpensive would become protracted and expensive;

— a procedure designed to permit parties to resolve a dispute privately, and without disrupting ongoing contractual relationships, would become a highly publicized, high-stakes lawsuit;

— a procedure designed to facilitate compromise would inhibit settlements by burdening them with costly and time-consuming procedural hurdles;

— parties would be less willing to enter into arbitration agreements since the risks associated with arbitration would be significantly increased while its efficiency and privacy would be diminished; and

— individual lawyers, accountants, architects, etc., would be less willing to volunteer their services as arbitrators, because few of them will have the time, patience or ability to participate in a massive proceeding of the kind contemplated by the California Supreme Court.

Class actions and arbitrations are each a useful procedural tool for resolving disputes. This Court need not decide that one is good, and the other bad. But the two are like oil and water and cannot be mixed, for the use of both at the same time would not be true to the objectives or procedures of either. One emphasizes speed, simplicity, informality and privacy, while the other requires caution, complexity, strict adherence to established procedures, and publicity.

This fundamental inconsistency between the two types of proceedings was recognized in the only other reported decision to consider the propriety of class action arbitration. In *Harris* v. *Shearson Hayden Stone, Inc.*, 82 A.D.2d 87, 441 N.Y.S.2d 70, 75-76 (1981), *aff'd mem.*, 56 N.Y.2d 627, 450 N.Y.S.2d

482, 435 N.E.2d 1097 (1982), the court held that a party should not be permitted to avoid arbitration of his individual claim by filing a class action in court. A dissenting justice felt that the policy favoring class actions should prevail over the policy favoring arbitration, but even he recognized that a class action necessarily is a *judicial* procedure, unsuited to the arbitration setting. 441 N.Y.S.2d at 79.

The California Supreme Court ignored this obvious incompatibility and justified its decision by erroneously assuming that individual, small claims might be "effectively foreclos[ed]" unless claimants are able to aggregate their resources by bringing class actions. (App. 25a.) The court overlooked the fact that the objectives of class actions (relieving burdens on the courts, reducing the cost of prosecuting individual claims) are served by arbitration in another way. Arbitration assists the administration of justice by consensually removing cases from the often tortuous route of the judicial system and by providing a quick, informal, inexpensive remedy to facilitate the prosecution of claims—particularly small claims. In other words, arbitration satisfies the principal goals that led to the creation of class actions without the delay, burden and expense which accompanies that procedure. *Cf. Harris* v. *Shearson Hayden Stone, Inc.*, 441 N.Y.S.2d at 76. The California Supreme Court's contrary assertion is unsupportable and should be rejected.[26]

The California Supreme Court was unrealistic when it suggested that hundreds or thousands of individual, duplicative arbitrations would occur unless it created an unprecedented class action procedure. (*See* App. 25a-29a.) The court cited no evidence to support the hypothesis that this sort of wasteful practice has occurred—either in the 7-Eleven convenience store

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26 Our research has not revealed any studies that support the proposition that individual arbitration has tended to thwart the prosecution of individual claims. Nor is there any support for that proposition in case law or commentary prior to this litigation. Moreover, the plaintiff-franchisees in the court below did not allege that it would be impossible or impractical to prosecute individual claims. Indeed, all of the plaintiffs are represented by the same attorneys and yet they filed some of the cases individually and some as purported class actions.

system or elsewhere—and we believe such evidence does not exist for several reasons. First, the typical case involves only one or a few claims, not hundreds or thousands. Class actions stir up litigation to some extent by creating claimants who have not previously felt aggrieved and who are not affirmatively interested in filing suit.[27] Thus, the true alternative to a class action in the instant litigation, and most others, is arbitration with a few claimants, not hundreds. Second, even if hundreds of claims were asserted, it is wrong to assume that it would be necessary to duplicate the expense of arbitrating each one individually. To the extent that the individual claims involved similar issues, the claimants could achieve substantial economies by retaining the same attorneys (as plaintiffs have done here), hiring the same expert witnesses, and so forth. Third, hundreds of repetitive proceedings would not benefit either side. In the real world, parties to contracts would probably agree to consolidate similar claims, or, if a number of arbitrations were decided in favor of one side or the other, they would likely conform their conduct to the results of those arbitrations. Fourth, if a party did attempt to engage in wasteful relitigation of hundreds of identical claims, arbitrators would at some point give precedential weight to the outcome of prior cases. Fifth, in positing that the "alternatives" were a single class action or hundreds of individual hearings, the court below overlooked the fact that a class action arbitration would *not* eliminate the need for hundreds of individual trials on "non-common" issues such as individualized damages, affirmative defenses and counterclaims.

In any event, the Federal Arbitration Act does not permit a court to upset the agreement of the parties on the ground that some other procedure would be more "efficient" in the particular case.[28] As the court stated in *Dickinson* v. *Heinold Securities, Inc.*, 661 F.2d 638, 646 (7th Cir. 1981):

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27 *Cf. Gulf Oil Co.* v. *Bernard*, 452 U.S. at 100 nn.11, 12 (potential of class action for "stirring up" litigation).

28 *See Scherk* v. *Alberto-Culver Co.*, 417 U.S. at 519 ("An agreement to arbitrate before a specified tribunal is, in effect, a specialized kind of forum-selection clause that posits not only the situs of the suit but

> [T]he Arbitration Act requires that we enforce the bargain of the parties as to dispute resolution and not substitute our own views of economy and efficiency. There is no room in the language of the Act, the decisions of the Supreme Court or the decisions of this court for an ad hoc approach, based on speculative considerations of efficiency toward enforcement of arbitration agreements.

Or, as the New York Court of Appeals has stated:

> The courtroom may not be used as a convenient vestibule to the arbitration hall so as to allow a party to create his own unique structure combining litigation and arbitration.

De Sapio v. *Kohlmeyer,* 35 N.Y.2d at 406, 362 N.Y.S.2d at 847, 321 N.E.2d at 773.

The California Supreme Court missed the mark when it attempted to analogize class action arbitrations to situations in which some lower courts have *consolidated* two separate arbitrations involving a common set of facts and three parties (*e.g.*, X initiates an arbitration with Y and Y files an arbitration demand against Z in a single dispute relating to a construction contract). (*See* App. 26a-28a.) As the dissenters recognized, the two situations are quite different. (App. 41a-42a.)[29] Consolidation of two arbitrations merely brings all three parties into one proceeding so that their mutually interdependent rights and liabilities can be adjudicated at one time. Significantly, it did not appear in any of the decided cases that consolidation would increase the duration or costs of the proceeding or the amount in controversy, that consolidation would pose manageability problems such as those presented by class actions, or that consolidation would interfere with the

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also *the procedure to be used* in resolving the dispute.") (emphasis supplied).

29 The dissenting justices also correctly noted that the authority of courts to compel parties to consolidate separate arbitrations is unsettled. (App. 42a.)

ability of the arbitrators to conduct the proceedings as they saw fit.[30] The courts in those cases were able to make a clear-cut, one-time decision whether the arbitrations should go forth separately or together, and could thereafter divorce themselves from the conduct of the proceedings. Moreover, in the consolidation setting each party can be personally represented rather than being forced to rely on the hope that someone else will adequately protect his interests. Thus, those cases did not involve any of the due process and impairment-of-arbitration issues presented here.

The California Supreme Court recognized that its class action procedure would be radically different than a normal arbitration and accordingly held that a party "should be given the option of remaining in court rather than submitting to classwide arbitration." (App. 30a.) A person presented with this Hobson's choice would almost surely elect the judicial forum. A class action arbitration would involve overlapping responsibility between two tribunals and would be even more complex, protracted and uncertain than a *judicial* class action. Moreover, while parties to contracts are often willing to forego their rights of appeal, discovery and adherence to rules of evidence in the context of an informal arbitration, waiver of these protections would involve decidedly different considerations in the context of a massive class action involving hundreds of litigants. Thus, the net result of a class action arbitration would be to take the controversy out of arbitration and back into court, effectively terminating the agreement to arbitrate.

As noted, the objective of the Federal Arbitration Act is to validate arbitration agreements in interstate commerce and to protect them from efforts by individual states to require the use of dispute-resolution procedures other than those chosen by the parties. The California Supreme Court's radical departure from established arbitration procedures thus presents substantial issues affecting the administration of justice and of federally protected rights, warranting close scrutiny by this Court.

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30 *See* the cases cited by the court below at App. 26a-27a.

B. The Federal Arbitration Act Supersedes the Anti-Arbitration Policy of the California Franchise Investment Law.

Under Section 2 of the Federal Arbitration Act, interstate arbitration agreements are "valid, irrevocable, and enforceable," and can be avoided only on the basis of legal or equitable principles that permit the revocation "of any contract." 9 U.S.C. § 2. This means that an agreement can be invalidated on the basis of *general principles* that are applicable to *any* contract (*e.g.*, fraud, duress, lack of legal capacity, waiver), but not on the basis of restrictive principles that are aimed at arbitration agreements in particular.[31]

The California Franchise Investment Law requires franchisors to make certain disclosures to prospective franchisees and renders unlawful the making of materially false or misleading statements. Aggrieved franchisees are given a cause of action, and Section 31512 of the statute renders unenforceable any agreement by a franchisee to waive rights given to him by the Franchise Investment Law. As interpreted by the court below,[32] any arbitration agreement constitutes a waiver of rights and accordingly is void under the state statute. This is true regardless of whether an agreement is entered into voluntarily by

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31 *E.g.*, *Collins Radio Co.* v. *Ex-Cell-O Corp.*, 467 F.2d 995, 997-98 (8th Cir. 1972); *Commonwealth Edison Co.* v. *Gulf Oil Corp.*, 541 F.2d 1263, 1268-70 (7th Cir. 1976); *Supak & Sons Mfg. Co.* v. *Pervel Industries, Inc.*, 593 F.2d 135, 137 (4th Cir. 1979).

32 The California Supreme Court was quite willing to discern an anti-arbitration policy in the California Franchise Investment Law, even though the state legislature had not addressed the subject in the statute. The California Franchise Investment Law contains no express provision prohibiting arbitration or even mentioning the subject of arbitration. Nor does the legislative history of the statute refer to arbitration. In contrast, another California statute, the California Franchise Relations Act, CAL. BUS. & PROF. CODE § 20040 (West 1982 Supp.), expressly declares that franchise disputes arising under that statute *are* arbitrable, and the California Supreme Court below was hard-pressed to explain why it would be appropriate to arbitrate controversies under one franchising statute but not the other. (*See* App. 12a-13a.)

persons with legal capacity, regardless of whether it satisfies all other requisites for the making of a valid contract, and regardless of whether it provides for an impartial decision under rules such as those of the American Arbitration Association.[33]

The premise of the California Franchise Investment Law, as construed by the state supreme court, is that arbitration of certain franchise disputes is inherently unfair or inappropriate (for reasons that the court below was at a loss to explain). Accordingly, the statute invalidates arbitration agreements between franchisors and franchisees, although such a legal impediment is not even-handedly applicable to all contracts. This policy might be valid as to strictly intrastate agreements, but it directly contravenes Section 2 of the Federal Arbitration Act and is therefore invalid with respect to interstate contracts.

The California Supreme Court based its contrary decision on a purported analogy between the state Franchise Investment Law and federal Securities Act of 1933, both of which require disclosures to prospective investors. It reasoned that since this Court had declared in *Wilko* v. *Swan*, 346 U.S. 427 (1953), that preexisting arbitration agreements are nonbinding as to claims arising under the federal statute, the same result should pertain to claims arising under the analogous California statute.

The analogy to *Wilko* is invalid on several grounds.[34] The most important is that *Wilko* did not involve a conflict be-

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33 The California Supreme Court did not base its decision on any finding that the 7-Eleven arbitration agreement is one-sided or that it would give any unfair advantage to the franchisor. The arbitration clause in the 7-Eleven franchise agreement stipulates that the rules of the American Arbitration Association shall be applied. These established rules, which have been incorporated into tens of thousands of commercial agreements across the country, provide, *inter alia*, for the selection of neutral arbitrators.

34 As the unanimous Court of Appeal and the dissenting justices in the California Supreme Court recognized, the 1953 decision in *Wilko* was based on the Court's conclusion that arbitration of a securities claim might cause a claimant to waive the benefit of the unusually liberal venue provision in the Securities Act of 1933. (*See* App. 67a-68a,

tween a *federal statute* regulating contracts in interstate commerce and a *state law* purporting to limit the federal statute. Rather, *Wilko* involved two federal laws, and the Court in that case was simply called upon to determine whether a particular provision in the subsequently enacted federal Securities Act of 1933 superseded the parties' agreement to arbitrate. Thus, *Wilko* has no bearing on the Supremacy Clause issue presented herein.

The decision of the California Supreme Court is in conflict with the decisions of several other state and federal courts which have rejected the *Wilko* "analogy" in the context of conflicts between the Federal Arbitration Act and state anti-arbitration statutes. They have held that the states are not free to enact anti-arbitration statutes applicable to contracts involving interstate commerce, because the federal statute overrides the state law by virtue of the Supremacy Clause.

For example, in *Allison* v. *Medicab International, Inc.*, 92 Wash. 2d 199, 597 P.2d 380, 382-83 (1979), which involved a state franchise disclosure statute similar to California's, the Washington Supreme Court rejected plaintiffs' argument that the state statute rendered arbitration agreements unenforceable, succinctly noting:

> Plaintiff cites *Wilko* v. *Swan*, . . . where the Supreme Court refused to enforce an arbitration clause when the dispute arose under the federal securities act. However,

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31a-32a.) This Court has suggested that *Wilko* may have been based on that narrow ground. *Scherk* v. *Alberto-Culver Co.*, 417 U.S. at 513-14. The California Franchise Investment Law does not contain a broad venue provision similar to the one in the federal Securities Act.

Other courts have held that in view of the strong policy *favoring* arbitration, the *Wilko* "analogy" should not be extended to other situations. *See Ingbar* v. *Drexel Burnham Lambert Inc.*, No. 82-1279, slip. op. (1st Cir. July 28, 1982) (rationale of *Wilko* does not extend to claims under Commodities Exchange Act); *Romnes* v. *Bache & Co.*, 439 F. Supp. 833, 838 (W.D. Wis. 1977) (same); *Middle East Transcontinental, Inc.* v. *Onion Crock, Inc.*, 144 Mich. App. 57 (1982) (*Wilko* rationale inapplicable to claims under Michigan Franchise Investment Law).

> this case involved two federal acts and not as here the federal arbitration act and a state franchising act.
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> . . . .
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> We hold that the supremacy clause of the federal constitution must prevail and thus the federal arbitration act requires enforcement of the arbitration clause in the franchise agreement despite the judicial remedies afforded by the [state] Franchise Investment Protection Act.

The same reasoning was applied by a federal court in *Barron* v. *Tastee Freez International, Inc.*, 482 F. Supp. 1213, 1216-17 (E.D. Wis. 1980), in holding that the Federal Arbitration Act prevails over any anti-arbitration policy of the Wisconsin Franchise Investment Act.

In the instant case, the three-judge panel of the California Court of Appeal, as well as the two dissenting justices in the state Supreme Court, agreed that the federal policy favoring arbitration supersedes any effort by California to prohibit arbitration of disputes to which the Federal Arbitration Act applies. (App. 31a-37a; 66a-70a.) *See also, e.g., Bache Halsey Stuart Shields, Inc.* v. *Moebius*, 531 F. Supp. 75 (E.D. Wis. 1982); *R.J. Palmer Construction Co.* v. *Wichita Band Instrument Co.*, 7 Kan. App. 2d 363, 642 P.2d 127 (1982); *Merrill Lynch Pierce Fenner & Smith Inc.* v. *Melamed*, 405 So. 2d 790 (Fla. Dist. Ct. App. 1981). In these and many other cases (a few of which are cited at App. 32a-37a), the courts have almost uniformly held that the Federal Arbitration Act establishes national substantive law that prevails over any contrary state policies.

In support of its conclusion that the California statute is not preempted by federal law, the California Supreme Court mistakenly relied on this Court's decision in *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Ware*, 414 U.S. 117 (1973). (App. 17a-18a.) *Ware* simply held that the particular state statute at issue in that case was not preempted by a particular federal statute because there was no conflict between them. *Ware* is

plainly distinguishable from the case at bar, which involves a direct federal-state conflict, and indeed, the preemption principles summarized in that case dictate the opposite conclusion here.[35]

As the Court noted in *Ware*, preemption depends on whether the state statute "frustrates any part of the purpose of the federal legislation." 414 U.S. at 139. The Court has similarly articulated the standard in other cases. For instance, in *Perez* v. *Campbell*, 402 U.S. 637 (1971), it was stated that a state statute is void under the Supremacy Clause if it " 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.' " 402 U.S. at 649, quoting *Hines* v. *Davidowitz*, 312 U.S. 52, 67 (1941). The Court reiterated this test in its recent decisions in *Chicago & N.W. Transp. Co.* v. *Kalo Brick & Tile Co.*, 450 U.S. at 317-18, and *Jones* v. *Rath Packing Co.*, 430 U.S. 519, 525-26 (1977). And in *Colorado Anti-Discrimination Comm'n* v. *Continental Air Lines, Inc.*, 372 U.S. 714, 722 (1963), the Court framed the issue in terms of whether the state enactment "is in direct conflict with federal law, . . . denies rights granted by Congress, or . . . stands as an obstacle to the full effectiveness of a federal statute."

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35 *Ware* involved an alleged conflict between a state Labor Code provision exempting wage disputes from arbitration and a New York Stock Exchange rule providing for compulsory arbitration of wage disputes between members of the exchange and their employees. This Court found that there was no conflict between the policies underlying the state statute and the policies underlying the federal securities laws (pursuant to which the stock exchange had promulgated its compulsory arbitration rule), and accordingly held that the state legislation was not preempted by the stock exchange rule.

Ware did not involve an alleged conflict between a state law and the Federal Arbitration Act. Therefore, as the California Supreme Court acknowledged, "the holding in the case is consequently not controlling here." (App. 18a.) (A likely reason why no issue under the Federal Arbitration Act was raised in *Ware* is the proviso in § 1 of the Act, which exempts from the coverage of the Act contracts of employment of workers engaged in interstate commerce.)

Under these principles, the California Franchise Investment Law must give way to the strong federal policy favoring arbitration. There is here a direct conflict between the state and federal statutes: One renders arbitration clauses in interstate franchise agreements unenforceable; the other provides that such agreements shall be "valid, irrevocable, and enforceable." Instead of supplementing federal remedies, the California franchising statute "denies rights granted by Congress." *Colorado Anti-Discrimination Comm'n*, 372 U.S. at 722. Finally, in view of the fact that Congress' objective in enacting the Federal Arbitration Act was to *expand* the availability of arbitration, it is plain that the California statute's constriction of that remedy, " 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.' " *Perez* v. *Campbell*, 402 U.S. at 649.

The California Supreme Court held that although the Federal Arbitration Act overrides any state policy that might be hostile "to arbitration generally," the Act allows the states to adopt "exceptions" to the general principle of arbitrability. (App. 15a-16a.) The court made no effort to define the subject areas or scope of the permissible exceptions, and there is in fact no sound basis for allowing a state to chip away at the federal arbitration remedy piece by piece. Under the reasoning of the California court, a state might be prohibited from eliminating the right to arbitration in one fell swoop, but it would be allowed to do so by means of a series of "exceptions." This year's exception could be for franchisor-franchisee disputes, next year's could be for disputes between lenders and borrowers, and the following year the state might ban the arbitration of tort claims. In each instance, the state could easily identify a "public policy" favoring judicial resolution of the category of disputes.

The California court's decision would also impair arbitration by inviting "unseemly and mutually destructive jockeying by the parties to secure tactical litigation advantages." *Scherk* v. *Alberto-Culver Co.*, 417 U.S. at 517. A party desiring to

avoid arbitration could, through artful pleading, structure his claims so as to fit within one of the state-created "exceptions" to arbitration.[36] It would also encourage forum shopping since the enforceability of an arbitration agreement would often depend on whether the claim were brought in state or federal court. (*See* App. 35a.) *See also Merrill Lynch Pierce Fenner & Smith Inc.* v. *Melamed,* 405 So. 2d at 792-93. This Court should not countenance such results. Just as the stability of international business transactions would be undercut if one country were to refuse to enforce international arbitration agreements based on parochial concerns, *Scherk* v. *Alberto-Culver Co.,* 417 U.S. at 516-517, orderliness and predictability in interstate commerce would be impaired if individual states

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36 This case offers a good example of the possibilities for such maneuvering. The claim in this litigation is that Southland misled the plaintiffs by misstating and failing to disclose material facts at the time they franchised their 7-Eleven stores. Accordingly, the primary allegation in plaintiffs' original pleadings was that Southland had engaged in intentional and negligent fraud in violation of common law. However, after the trial court had ruled that claims based on the California Franchise Investment Law are nonarbitrable, new complaints were filed in two of the consolidated cases (*Coy* and *Scovis*); these pleadings contained a single count, based on the Franchise Investment Law. Plaintiffs' counsel candidly conceded to the trial court that they had phrased their claims as statutory violations, and not as common law causes of action, for the express purpose of avoiding their contractual commitment to arbitrate their disputes. *See* plaintiffs' "Memorandum of Points and Authorities in Opposition to Petition to Compel Arbitration," at 3-4 (filed July 17, 1978), where plaintiffs' attorneys stated:

> [M]ay these plaintiffs . . . avoid arbitration by limiting their complaints to causes of action under the Franchise Investment Law? The answer to this question is clearly: yes, of course they can. . . . Having had the benefit of guidelines provided by the Court, plaintiffs' counsel have filed pleadings best calculated to both present the essential claims of the particular plaintiffs involved, and to plead an effective class action . . . .

were free to create "exceptions" to the arbitrability of disputes involving interstate contracts."

State-created "exceptions" would fly in the face of the express language of Section 2 of the Federal Arbitration Act, and would also violate the intent of Congress, which was to provide for the uniform treatment of interstate arbitration agreements among the states. If this policy is deemed to be unduly broad, California's remedy is not to enact its own contradictory legislation, but to petition Congress to modify the law to permit the states to restrict the permissible subjects of arbitration.

CONCLUSION

The decision of the California Supreme Court opens the door to widespread efforts by state legislatures and courts to declare various areas of interstate commerce to be "off limits" for arbitration under the Federal Arbitration Act. In addition, the California court's ruling would saddle the remaining, arbitrable disputes with burdensome, self-defeating, judicial class action procedures. The court's ruling on both issues is in conflict with decisions of numerous other courts, which have given full effect to the strong policy favoring arbitration embodied in the federal statute.

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37 In the instant case, the court below suggested that plaintiffs might be able to avoid their duty to arbitrate altogether—both with respect to their statutory claims and their common law claims—by asserting a claim under the Franchise Investment Law. (App. 18a n.15.)

For these reasons, we respectfully submit that this appeal presents substantial legal issues requiring full consideration by this Court.[38]

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September 1982

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38 If this Court should conclude that this case does not fall within its appellate jurisdiction, Southland requests that this jurisdictional statement be treated as a petition for a writ of certiorari, in which case jurisdiction is invoked pursuant to 28 U.S.C. § 1257(3) (1976). *See* 28 U.S.C. § 2103 (1976).

82-500

No. 82-____

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

THE SOUTHLAND CORPORATION, *et al.*,

Appellants,

—v.—

RICHARD D. KEATING, *et al.*,

Appellees.

ON APPEAL FROM THE SUPREME COURT OF CALIFORNIA

APPENDIX TO JURISDICTIONAL STATEMENT

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APPENDIX A

IN THE SUPREME COURT OF
THE STATE OF CALIFORNIA

S.F. 24242

(Superior Court No. 469216-2)

RICHARD D. KEATING et al.,

Petitioners,

—v.—

THE SUPERIOR COURT OF ALAMEDA COUNTY,

Respondent;

SOUTHLAND CORPORATION et al.,

Real Parties in Interest.

EDWARD J. GOUVEIA et al.,

Plaintiffs and Respondents,

—v.—

SOUTHLAND CORPORATION et al.,

Defendants and Appellants.

[And 7 other cases.]*

Filed June 10, 1982

SEE CONCURRING AND DISSENTING OPINION

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* Cheng v. Southland Corporation (Super. Ct. No. 505162-3); Newell v. Southland Corporation (Super. Ct. No. 505164-1); Sampson v. Southland Corporation (Super. Ct. No. 505161-4); Battersby v. Southland Corporation

These coordinated cases arise out of disputes between Southland Corporation (Southland), owner and franchisor of 7-Eleven convenience food store operations throughout the country, and persons who are, or were, franchised operators of 7-Eleven stores in California. The issues before us do not concern the merits of those disputes, but rather the forum and procedure for their resolution. Southland contends that the disputes should be submitted to arbitration on an individual (i.e., franchisee-by-franchisee) basis, pursuant to an arbitration provision contained in its agreement with each franchisee. The franchisees, who have sued Southland[1] in both individual and class actions on a variety of grounds, and who are all represented by the same law firm, contend alternatively that the arbitration provisions are not enforceable on adhesion grounds; that insofar as the disputes involve alleged violation by Southland of the Franchise Investment Law they are not subject to arbitration; and that Southland has waived its right to insist upon arbitration in certain of the cases. Franchisees also contend that if there is to be arbitration it should proceed on a classwide, rather than individual, basis. We will hold that the adhesive nature of the franchise contract is not itself a bar to enforcement of the arbitration provision, but that the trial court properly excluded claims based upon alleged violation of the Franchise Investment Law. We will affirm the trial court's holding that there has been no waiver by Southland of its right to insist upon arbitration; but we will remand to the trial court for determination as to whether the interests of justice require that the order to arbitrate be conditioned upon Southland's acceptance of classwide arbitration.

We first describe the factual and procedural background relevant to analysis. Under the terms of Southland's standard

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(Super. Ct. No. 390132); Keating v. Southland Corporation (Super. Ct. No. 505159-9); Coy v. Southland Corporation (Super. Ct. No. 506120-6); and Scovis v. Southland Corporation (Super. Ct. No. C-235779).

1 The suits also named certain corporate officers as defendants, but as the parties do not distinguish them with respect to the issues presented here, we shall use the term Southland to include both the corporation and its officers.

7-Eleven franchise agreement (hereafter the agreement(s)), Southland provides each franchisee with a license to use certain nationally known and federally registered trademarks, a lease or sublease of certain convenience food stores owned or leased by Southland, the financing of store inventories, and advertising and merchandising assistance. The franchisees, in turn, operate the stores, supply Southland with certain bookkeeping data, make bank deposits of receipts from the operation of the stores, and pay Southland a fixed percentage of gross profits. Each of the agreements contains an arbitration clause providing, essentially, that "[a]ny controversy or claim arising out of or relating to this Agreement or the breach thereof shall be settled by arbitration in accordance with the Rules of the American Arbitration Association . . . and judgment upon any award rendered by the arbitrator may be entered in any court having jurisdiction thereof."

Between September 1975 and January 1977, franchisees Gouveia, Sampson, Cheng and Newell (and one other franchisee whose claim has since been settled) filed individual actions against Southland alleging, among other things, fraud, oral misrepresentation, breach of contract, breach of fiduciary duty, and violation of the disclosure requirements of the Franchise Investment Law (Corp. Code, § 31000 et seq.). In each of these actions except *Gouveia,* Southland filed an answer in which the failure to arbitrate was an affirmative defense, but it took no further steps based on that defense at the time, nor did it actively seek arbitration until after the *Keating* action was filed. In *Gouveia, Newell* and *Sampson* it filed cross-complaints, and participated in discovery, including taking the depositions of each of the named plaintiffs.

In May 1977 franchisee Keating filed a class action on behalf of an asserted class composed of approximately 800 Southland franchisees in California, alleging claims substantially similar to those being claimed by the other franchisees, and alleging also that Southland's accounting procedures were unfair and inaccurate. Southland promptly removed *Keating* to the federal district court, and filed an answer and counterclaim to the complaint. A few days later, it filed an amended answer

asserting arbitration as a defense. When *Keating* was remanded to the state courts, at franchisees' request, Southland petitioned to compel arbitration in all of the pending cases, but ruling on that petition was stayed pending determination of a motion by the franchisees for coordination of the actions. By this time, the list of actions included a class action filed by franchisee Battersby, and the parties stipulated that *Battersby* would be governed by the rulings in *Keating*.

In November 1977, the motion to coordinate the various actions was granted by the Judicial Council, on condition that franchisees file substantially amended complaints which would demonstrate the asserted similarities among the actions. The amended complaints contain substantially comparable allegations including claims of misrepresentations in connection with the sale of the franchises and inaccurate information about fees, discounts, and the overall performance of 7-Eleven stores.

Except for the claims based on the Franchise Investment Law, the trial court granted Southland's motions to compel arbitration in each of the coordinated actions, without passing upon the franchisees' request for class certification. Southland then appealed from the order to arbitrate insofar as it excluded claims based on the Franchise Investment Law, and the franchisees filed a petition for writ of mandate or prohibition seeking relief from the order to arbitrate on the various grounds stated above. We proceed to consider the issues presented in the order most convenient for discussion. Initially, we observe that since the franchise agreements were between a Texas corporation and California residents, entailed the right to use federally registered trademarks, and contemplated a continuing business relationship between the parties across state lines, they involve interstate commerce and fall within the ambit of the Federal Arbitration Act. (9 U.S.C. § 2.)[2] We shall,

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2 Section 2 provides: "A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an

therefore, take that statute into account in passing upon the issues presented.

I. ADHESION.

In his declaration in opposition to Southland's petition to compel arbitration, Keating stated the franchise agreement was presented to him by Southland representatives on a take-it-or-leave-it basis, with no opportunity to bargain or to negotiate; and that other than the information set forth in the franchise agreement itself, and a pamphlet of the American Arbitration Association describing their procedures, he was "given no verbal or written explanation of the meaning of arbitration, the concept of an arbitration proceeding, the fact that it involved [his] waiver of [his] constitutional rights to a jury trial, a loss of the right to utilize the protection of the courts in the discovery process, nor any information with respect to what arbitration would cost in a procedure of this type." He, and the other franchisees who, in effect, adopt his declaration, contend that the declaration raised questions of fact concerning the enforceability of the arbitration clauses which should have been resolved before arbitration was ordered. The trial court ordered arbitration notwithstanding these contentions. On this score, we find no error.

We accept franchisees' characterization of the franchise agreements, and hence the arbitration agreements, as contracts of adhesion, " . . . 'a standardized contract, which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it.' " (Graham v. Scissor-Tail, Inc. (1981) 28 Cal.3d 807, 817, quoting from Justice Tobriner's decision in Neal v. State Farm Ins. Cos. (1961) 188 Cal.App.2d 690, 694.) It is undisputed that the franchise agreements in question here are standardized in form, at least as regards the

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agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."

arbitration provision; and that they are drafted and imposed by defendant, a large corporation of vastly superior bargaining strength, upon all parties desiring a 7-Eleven franchise. The California Legislature has determined that franchisees are in need of special protection in dealing with franchisors. (Corp. Code, § 31001, see generally Corp. Code, § 31000 et seq.)[3] While the franchisees were financially interested in establishing a beneficial business relationship with Southland, and while that interest may not constitute a "needed service" in the sense envisaged in *Madden* v. *Kaiser Foundation Hospitals* (1976) 17 Cal.3d 699, 711, or a "service of great importance to the public" as contemplated in *Tunkl* v. *Regents of University of California* (1963) 60 Cal.2d 92, 99, it is now clear that those factors are not prerequisite to a finding of adhesion. (Graham v. Scissor-Tail, Inc., supra, 28 Cal.3d at pp. 818, 820, fn. 18.)

It does not follow, however, that the contracts are unenforceable. "To describe a contract as adhesive in character is not to indicate its legal effect. It is, rather, 'the beginning and not the end of the analysis insofar as enforceability of its terms is concerned.' [Citation.]" (Graham v. Scissor-Tail, Inc., supra, 28 Cal.3d at p. 819.) "Thus, a contract of adhesion is fully

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3 Corporations Code section 31001 provides, "The Legislature hereby finds and declares that the widespread sale of franchises is a relatively new form of business which has created numerous problems both from an investment and a business point of view . . . . [¶] It is the intent of this law to provide each prospective franchisee with the information necessary to make an intelligent decision regarding franchises being offered. Further, it is the intent of this law . . . to protect the franchisor by providing a better understanding of the relationship between the franchisor and franchisee with regard to their business relationship." (See Damon, *Franchise Investment Law* (1971) 2 Pacific L.J. 27, 27-30, 35-36.) The need for such "special protection" has been recognized in other states and by the federal government who have enacted similar legislation. (15 U.S.C. § 45(a)(1) (1964); Fla. Stat. Ann., § 817.416 (1971) and Rules Chap. 2-17 (1974); Hawaii Rev. Stat., § 482 E-1 (1974); Ill. Rev. Stat., ch. 121-1/2, § 702 (1974); Ind. Code, § 23-2-2.5-47 (1975); Mich. Stat. Ann., § 19.854(1) (1974); Minn. Stat., § 800.01 (1973); Ore. Rev. Stat., § 650.007, rule 40-050 (1975); R.I. Gen. Laws, § 19-28-2 (1973); Va. Code, § 13.1-558 (1972); Wash. Rev. Code, § 19.100.010 (1972); and Wis. Stat., § 553.01 (1972) Admin. Code, § 31.01.)

enforceable according to its terms [citations] unless certain other factors are present which, under established legal rules—legislative or judicial—operate to render it otherwise." (Id., at pp. 819-820.) "Generally speaking, there are two judicially imposed limitations on the enforcement of adhesion contracts or provisions thereof. The first is that such a contract or provision which does not fall within the reasonable expectations of the weaker or 'adhering' party will not be enforced against him. [Citations.] The second—a principle of equity applicable to all contracts generally—is that a contract or provision, even if consistent with the reasonable expectations of the parties, will be denied enforcement if, considered in its context, it is unduly oppressive or 'unconscionable.' " (Id., at p. 820.)

Arbitration in the setting of a contract of adhesion does pose special problems, both because arbitration necessarily entails relinquishment of the constitutional right to trial by jury and because it is susceptible of being structured, or utilized, in such a way as to gain unfair advantage to the party with superior bargaining power. *Graham* v. *Scissor-Tail, Inc.*, supra, 28 Cal.3d 807, in which the agreement called for arbitration by a presumptively partial tribunal, provides an example of that sort of unfairness (see also, Hope v. Superior Court (1981) 122 Cal.App.3d 147). As we shall discuss later in this opinion, reliance upon individual arbitration agreements to insulate the stronger party from otherwise appropriate class actions may also be inequitable depending upon the circumstances.

In the absence of some special element of unfair advantage, however, arbitration is generally considered to be a mutually advantageous process, providing for resolution of disputes in a presumptively less costly, more expeditious, and more private manner by an impartial person or persons typically selected by the parties themselves. (See Madden v. Kaiser Foundation Hospitals, supra, 17 Cal.3d 699.) For these reasons, the fact that provision for arbitration is contained in a contract of adhesion will not, of itself, render the provision unenforceable. (Graham v. Scissor-Tail, Inc., supra, 28 Cal.3d at pp. 819-820.)

Moreover, provision for arbitration in a commercial context is quite common, and reasonably to be anticipated. Indeed, Keating's declaration itself makes clear that he was aware of the provision, and of the American Arbitration Association pamphlet making reference to the applicable rules. In such a setting neither he nor the other franchisees are in a position to claim that the arbitration provision itself, or the fact that it would entail waiver of jury trial, lack of formal discovery, or certain costs, did not "fall within [their] reasonable expectations." (Graham v. Scissor-Tail, Inc., supra, 28 Cal.3d at p. 820.)

For these reasons, we conclude that the arbitration provisions of the franchise agreement were, in general, binding and enforceable. We proceed now to consider the remaining issues.

II. Arbitrability of Franchise Investment Law Claims.

We next consider Southland's appeal from the trial court's denial of its petitions to compel arbitration concerning certain claims made against it pursuant to the Franchise Investment Law (Corp. Code, § 31000 et seq.). These claims assert, among other things, that Southland systematically violated section 31202[4] of the Corporations Code by willfully making untrue statements of material fact, and by willfully omitting to state material facts which are required to be stated in statements required to be disclosed under section 31101.[5] The trial court was apparently of the view that these claims were not subject to arbitration as a matter of contract interpretation and also as a consequence of Corporations Code section 31512, part of the Franchise Investment Law, which provides: "Any condition, stipulation or provision purporting to bind any person ac-

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4 Section 31202 provides: "It is unlawful for any person willfully to make any untrue statement of a material fact in any statement required to be disclosed in writing pursuant to Section 31101, or willfully to omit to state in any such statement any material fact which is required to be stated therein."

5 Section 31101, subdivision (c) listed some 15 items of information to be disclosed.

quiring any franchise to waive compliance with any provision of this law or any rule or order hereunder is void." Since we agree with the latter conclusion we find it unnecessary to consider the former.

In *Wilko* v. *Swan* (1953) 346 U.S. 427, the United States Supreme Court interpreted nearly identical language in section 14 of the Securities Act of 1933 (15 U.S.C. § 77n)[6] to permit suit by a customer against a securities brokerage firm for alleged misrepresentation in the sale of securities, notwithstanding a provision for arbitration contained in the margin agreement. The arbitration clause, the court decided, constituted a "stipulation," and the right to select the judicial forum the kind of "provision" that could not be waived in advance under section 14. (346 U.S. at pp. 434-435.) In arriving at this conclusion, the court observed that section 12(2) of the act "created a special right to recover for misrepresentation which differs substantially from the common-law action in that the seller is made to assume the burden of proving lack of scienter" (346 U.S. at p. 431), and that this "special right" was enforceable in any court of competent jurisdiction, with a wide choice of venue (ibid.). The court placed primary emphasis, however, upon the proposition that the effectiveness of the statute "is lessened in arbitration as compared to judicial proceedings" (id., at p. 435), in part because of the limited nature of judicial review (id., at p. 436). "As the protective provisions of the Securities Act require the exercise of judicial direction to fairly assure their effectiveness, it seems to us that Congress must have intended [the waiver provision] to apply to waiver of judicial trial and review (id., at p. 437).[7]

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6 That language reads: "Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void."

7 In *Scherk* v. *Alberto-Culver Co.* (1974) 417 U.S. 506, the Supreme Court declined to apply the *Wilko* rule to a suit under section 10(b) of the Securities Exchange Act of 1934 and rule 10b-5 thereunder, for rescission of a purchase agreement by which Alberto-Culver Co., an American corpora-

The evidence is persuasive that in drafting the Franchise Investment Law California legislators looked to the Securities Act of 1933 as their model. Not only do the two statutes have the same purpose of protecting investors through preinvestment disclosure statements, but their parallel provisions are often expressed in identical language.[8] Corporations Code section 31301 contains substantially the same provision relating

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tion, purchased the trademarks and stock of two foreign corporations. In reaching this conclusion, the court relied primarily on the international character of the transaction, reasoning that "[a] parochial refusal by the courts of one country to enforce an international arbitration agreement would not only frustrate [policies of certainty and predictability], but would invite unseemly and mutually destructive jockeying by the parties to secure tactical litigation advantages." (Id., at pp. 516-517.) While the court made reference to the fact that the Securities Exchange Act did not contain the liberal venue provisions of the Securities Act, and suggested that a "colorable argument" could be made for distinguishing *Wilko* on that ground (id., at p. 513), subsequent cases have continued uniformly to apply the *Wilko* v. *Swan* rule to actions brought by customers against brokerage houses under the Securities Exchange Act, limiting *Scherk* to the arena of international securities transactions. (Merrill Lynch, Pierce, Fenner & Smith v. Moore (10th Cir. 1978) 590 F.2d 823; accord, Mansbach v. Prescott, Ball & Turben (6th Cir. 1979) 598 F.2d 1017; Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc. (7th Cir. 1977) 558 F.2d 831; Sibley v. Tandy Corp. (5th Cir. 1977) 543 F.2d 540; Ayres v. Merrill Lynch, Pierce, Fenner & Smith (3d Cir. 1976) 538 F.2d 532.) The Second Circuit has suggested that the relatively equal bargaining status of the parties in *Scherk* was also a distinguishing factor. (Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith Inc., supra, 558 F.2d at p. 835; see generally, Gruenbaum, *Avoiding the Protections of the Federal Securities Laws: The Anti-Waiver Provisions* (1980) 20 Santa Clara L.Rev. 49.)

8 Compare the definition of "sale" under section 2 of the Securities Act (15 U.S.C. § 77(b)(2)) with that in Corporations Code section 31018; the definition of "misrepresentations by omission" in section 17(2) of the Securities Act (15 U.S.C. § 77*l*(2)) with Corporations Code section 31201; the burden of proving due diligence of section 12 of the Securities Act (15 U.S.C. § 77k(b)(3)) with Corporations Code section 31301; the provision for injunction actions in section 20 of the Securities Act (15 U.S.C. § 77t(a)) with Corporations Code section 31400; and the liability of control persons of section 15 of the Securities Act (15 U.S.C. § 77o) with Corporations Code section 31302.

to scienter as the United States Supreme Court relied upon in *Wilko*.[9] And, as we have observed, the waiver language of the two statutes is virtually identical.

"This court has long recognized the principle of statutory construction that '[w]hen legislation has been judicially construed and a subsequent statute on the same or an analogous subject is framed in the identical language, it will ordinarily be presumed that the Legislature intended that the language as used in the later enactment would be given a like interpretation. This rule is applicable to state statutes which are patterned after the federal statutes. [Citations.]' " (Belridge Farms v. Agricultural Labor Relations Bd. (1978) 21 Cal.3d 551, 557.)

The presumption established by that principle of statutory construction is reinforced by the language and history of the recently adopted California Franchise Relations Act (Bus. & Prof. Code, § 20000 et seq.), regulating the grounds and procedure for termination and nonrenewal of franchises. That statute stemmed from hearings conducted in late 1977 by a subcommittee of the state Assembly Committee on Finance, Insurance, and Commerce, chaired by Assemblyman Bruce Young. A preliminary report prepared by that committee prior to hearings refers to the Franchise Investment Law as a "pre-purchase disclosure law patterned after the Securities Act of 1933," discusses various proposals for extending regulation of franchise relationships, and poses various rhetorical questions in that regard, among them the following: "Present law provides for the resolution of franchisee/franchisor disputes through the judicial system. Should the law be modified to provide for other means of resolution such as compulsory

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9 Section 31301 provides: "Any person who violates Section 31201 shall be liable to any person (not knowing or having cause to believe that such statement was false or misleading) who, while relying upon such statement shall have purchased a franchise, for damages, unless the defendant proves that the plaintiff knew the facts concerning the untruth or omission or that the defendant exercised reasonable care and did not know, (or if he had exercised reasonable care would not have known) of the untruth or omission."

arbitration and/or a Board of Franchising?"[10] The Franchise Relations Act as ultimately adopted by the Legislature contains both a nonwaiver provision nearly identical to Corporations Code section 31512 and the following provision authorizing limited arbitrability of disputes under that statute: "Nothing contained in this chapter shall limit the right of a franchisor and franchisee to agree before or after a dispute has arisen to binding arbitration of claims under this chapter, provided that: (a) The standards applied in such arbitration are not less than the requirements specified in this chapter; and (b) The arbitrator or arbitrators employed in such arbitration are chosen from a list of impartial arbitrators supplied by the American Arbitration Association or other impartial person." (Bus. & Prof. Code, § 20040.) The inference is strong, if not inescapable, that the Legislature understood the anti-waiver provision of the Franchise Investment Law to be subject to the *Wilko* (346 U.S. 427) interpretation, and that it intended to establish a different rule for the Franchise Relations Act.[11] While we have no evidence as to the policy reasons underlying that distinction, it may be that the Legislature considered arbitration more acceptable in the context of franchise relationships already

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10 Assembly Committee on Finance, Insurance, and Commerce, Ad Hoc Subcommittee on Franchising, An Evaluation of the Regulation of Franchising in California and Prospective Legislative Revisions—Background Notes for Interim Study, page 6.

11 This inference is supported by the following legislative history. Assemblyman Young, who was the author of the bill which became the Franchise Relations Act, sponsored an earlier bill (Assem. Bill No. 944 (1977 Reg. Sess.)) which provided for similar restrictions upon termination of franchises through addition of a new chapter (§ 31220 et seq.) to the Corporations Code. That bill contained a section providing for a similar nonwaiver provision which read as follows: "31224: (a) *Except as provided in subdivision (b) of this section*, any condition, stipulation, provision, or term of any franchise agreement waiving any rights granted under the chapter or relieving any person from liability imposed by this chapter shall be void and unenforceable." (Emphasis added.) Subdivision (b) permitted agreements for "binding arbitration of disputes" subject to the restrictions presently contained in the new law.

established, presumably on the basis of proper disclosure, or that it considered the more detailed provisions in the Franchise Investment Law for civil liability (Corp. Code, § 31300), administrative regulation (Corp. Code, § 31400) and criminal liability (Corp. Code, § 31410 et seq.), to require access to the courts and "the exercise of judicial direction to fairly assure their effectiveness." (Wilko v. Swan, supra, 346 U.S. at p. 437.)

Having determined that the California Legislature intended the nonwaiver provision of the California Franchise Act to be interpreted in accord with *Wilko* v. *Swan*,[12] we turn to Southland's contention that the statute as so construed may not constitutionally be applied to a "contract evidencing a transaction involving commerce" within the meaning of the Federal Arbitration Act (FAA). The argument is that the FAA, in mandating that a provision for arbitration in such a contract "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract" (FAA, § 2), establishes a general principle of arbitrability which preempts any state law or policy restrictive of arbitration, whatever the basis for that law or policy might be, and whether or not federal jurisdiction over the underlying controversy exists. We consider that argument overly broad.

The starting point for analysis is *Prima Paint* v. *Flood & Conklin* (1967) 388 U.S. 395, in which the Supreme Court held that in a federal court diversity action involving a contract subject to the FAA, a claim of fraud in the inducement of the contract (as distinguished from a claim of fraud in the inducement of the arbitration clause), is a question for the arbitrator, and not the court, to decide; and that this rule applies even though the law of the state in which the contract was to be performed might have a different rule.

The Supreme Court in *Prima Paint* rejected the contention that it was "constitutionally impermissible" to apply the FAA

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12 As in *Wilko*, the agreement here was to arbitrate such disputes as might arise in the future. We express no view as to the enforceability of an agreement to arbitrate a pending dispute under the Franchise Investment Law.

because the case was in the federal court solely by reason of diversity of citizenship. "[T]he question," the court said, "is not whether Congress may fashion federal substantive rules to govern questions arising in simple diversity cases . . . [but] whether Congress may prescribe how *federal* courts are to conduct themselves with respect to subject matter over which Congress plainly has power to legislate." (Id., at p. 405; emphasis added.) The opinion thus left open the question whether or under what circumstances *state* courts are constitutionally obligated to apply the substantive principles inherent in the federal statute.

Shortly after *Prima Paint* was decided, the New York Court of Appeals indicated it would apply FAA principles to a maritime transaction "even if such a result is not constitutionally mandated by the decision in *Prima Paint*," in order to discourage forum shopping between state and federal courts. (A/S J. Ludwig Mowinckels R. v. Dow Chem. Co. (1970) 307 N.Y.S.2d 660, 666.) Since then a number of courts, both federal and state, have adopted the view that while the FAA is not itself a source of federal jurisdiction, the statute contains certain principles of "substantive federal law" which must be applied, regardless of forum, where federal jurisdiction exists. (E.g., In re Mercury Const. Corp. (4th Cir. 1981) 656 F.2d 933, 938; E. C. Ernst, Inc. v. Manhattan Const. Co. of Texas (5th Cir. 1977) 551 F.2d 1026, 1040; Pathman Const. Co. v. Knox County Hospital Ass'n (1975) 326 N.E.2d 844, 851; Episcopal Housing Corp. v. Federal Ins. Co. (1977) 239 S.E.2d 647; Main v. Merrill Lynch, Pierce, Fenner & Smith, Inc. (1977) 67 Cal.App.3d 19, 24-25.)

While the federal district court in this case, by its remand, determined that federal jurisdiction over the franchisees' lawsuit did *not* exist, the likely explanation for that determination is the presence in the case of defendants whose citizenship precludes requisite diversity. Accordingly, we do not decide the preemption issue on that narrow ground (see In re Mercury Const. Corp., supra, 656 F.2d at p. 942).

Rather, we confront squarely the underlying issue of statutory interpretation: whether the principles of *"substantive*

federal law" embodied in the FAA, preclude a state from protecting its franchise investors through a system of statutory regulation including nonwaivable judicial remedies. While there is authority for an affirmative answer (Allison v. Medicab Intern., Inc. (1979) 597 P.2d 380, 383; Barron v. Tastee Freez Intern., Inc. (E.D. Wis. 1980) 482 F.Supp. 1213), we respectfully disagree.

The FAA was adopted in 1925 (43 Stat. 883), against a background of judicial hostility to arbitration generally. (See Kulukundis Shipping Co. v. Amtorg Trading Corp. (2d Cir. 1942) 126 F.2d 978, 984; Sayre, *Development of Commercial Arbitration Law* (1927) 37 Yale L.J. 595.) The apparent purpose of the statute was to remove that hostility, and so "make the benefits of arbitration generally available to the business world." (Robert Lawrence Company v. Devonshire Fabrics, Inc. (2d Cir. 1959) 271 F.2d 402, 407.) While there is nothing in the legislative history of the statute to suggest that Congress considered its application to state courts (see, Sturges and Murphy, *Some Confusing Matters Relating to Arbitration Under the United States Arbitration Act* (1952) 17 Law & Contemp. Prob. 580, passim), we assume that Congress intended to insulate interstate contracts from judicial hostility regardless of forum (see Fite & Warmath Const. Co., Inc. v. MYS Corp. (Ky. 1977) 559 S.W.2d 729), and to establish for such contracts certain uniform rules of interpretation (see Guinness-Harp Corp. v. Jos. Schlitz Brewing (2d Cir. 1980) 613 F.2d 468, 472.)

In these respects, California law is entirely in accord. Two years after the FAA was enacted, this state adopted its first modern arbitration statute (Stats. 1927, ch. 225), declaring arbitration agreements to be irrevocable and enforceable in terms identical to those used in section 2 of the federal act, and since that time California courts and its Legislature have "consistently reflected a friendly policy toward the arbitration process." (Kagel, A Study Relating to Arbitration, in Cal. Law. Revision Com. Recommendations and Study Relating to Arbitration (1960) p. G-28.) That policy was expanded and clarified in the current arbitration statute which was adopted in

1961 (Stats. 1961, ch. 461, § 2 et seq.), and it continues to be the policy of this state (e.g., Doers v. Golden Gate Bridge etc. Dist. (1979) 23 Cal.3d 180, 189).

Adoption of an affirmative policy toward enforcement of arbitration agreements has never implied, however, that all types of disputes are subject to arbitration. In New York, for example, one of the earliest states to encourage arbitration through statute, certain categories of disputes are insulated from arbitration as a matter of public policy. (See Associated Teachers, etc. v. Bd. of Ed. (1979) 33 N.Y.2d 229 [351 N.Y.S.2d 670].) Among these are disputes under state antitrust laws, on the ground that "through the use of economic power and contracts of adhesion, containing broad arbitration clauses, antitrust violators may be able to insulate their transgressions of the antitrust law from judicial scrutiny." (Aimcee Wholesale Corp. v. Tomar Products (1968) 21 N.Y.2d 621, 629 [289 N.Y.S.2d 968, 973-974].) The same is true of matters involving the liquidation of insolvent insurance companies (Knickerbocker Agency v. Holz (1958) 4 N.Y.2d 245 [173 N.Y.S.2d 602, 607-610]), or the usurious character of a purported sales agreement (Durst v. Abrash (1964) 253 N.Y.S.2d 351, 353).

Such exceptions to the general principle of arbitrability, like those expressed in California's Franchise Investment Law, do not reflect hostility toward arbitration, nor do they constitute an obstacle to the general enforcement of arbitration agreements in a manner consistent with federal law. Rather, such exceptions are narrowly confined to rights and remedies created by state regulatory statutes, and represent a determination that the public interest is best served by maintaining access to the remedies which the Legislature has provided. That Congress intended, through the FAA, to override state policies of that nature seems highly improbable.

The question in this case might be more debatable were it not for the fact that California's policy of protecting judicial remedies for this state's franchise investors was patterned after, and is consistent with, federal policy in the analogous area of

securities investment.[13] There is no suggestion that Congress has preempted the field of franchise investor regulation as it has, for example, the field of labor relations (cf. Teamsters Union v. Oliver (1959) 358 U.S. 283), or that the FAA embodies substantive principles intrinsic to a federally regulated field (cf. Textile Workers v. Lincoln Mills (1957) 353 U.S. 448). Having left states with power to enact laws in this area, it is hardly likely that Congress intended to preclude them from adopting policies which Congress itself has found to be appropriate.[14]

Preemption principles were recently summarized by the United States Supreme Court in *Merrill Lynch, Pierce, Fenner & Smith* v. *Ware* (1973) 414 U.S. 117, holding that California's statutory policy excluding wage claims from arbitration (Lab. Code, § 229) was not preempted by rules promulgated by the New York Stock Exchange pursuant to federal law: " 'The principle to be derived from our decisions is that federal regulation of a field of commerce should not be deemed preemptive of state regulatory power in the absence of persuasive reasons—either that the nature of the regulated subject matter permits no other conclusion, or that the Congress has unmistakably so ordained.' [Citation.] [¶] In other contexts, pre-emption has been measured by whether the state statute frustrates any part of the purpose of the federal legislation. [Citations.] And . . . while prior cases on pre-emption 'are not precise guidelines,' because each case turns on the peculiarities and special features of the federal regulatory scheme in ques-

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13 We observe that California's Corporate Securities Law contains a substantially identical nonwaiver provision (Corp. Code, § 25701). Southland's argument would preclude its application to interstate transactions as well.

14 Southland observes that two federal statutes which regulate franchise relationships (Petroleum Marketing Practices Act (15 U.S.C. § 2801 et seq.) and Automobile Dealer Suits Against Manufacturers (15 U.S.C. § 1221 et seq.) do not contain provisions similar to 15 United States Code section 77n. Neither of these statutes impose analogous disclosure requirements however, nor has the issue of arbitrability of disputes under them been litigated in reported cases.

tion, it is where there is in existence a pervasive and comprehensive scheme of federal regulation that pre-emption follows in order to fulfill the federal statutory purposes. [Citations.] [¶] In the area of regulation that we are considering here, California has manifested a strong policy of protecting its wage earners from what it regards as undesirable economic pressures affecting the employment relationship. This policy prevails in the absence of interference with the federal regulatory scheme. We find no such interference . . . ." (414 U.S. at p. 139-140.)

The court in *Ware* did not consider the applicability of the FAA, and the holding in the case is consequently not controlling here, but the principles which the court announced strongly support rejection of Southland's argument. Not only has California "manifested a strong policy of protecting its [franchise investors] from what it regards as undesirable economic pressures affecting the [franchise] relationship" (ibid.), it has done so through a regulatory scheme containing remedies which it has deemed appropriate to protect against waiver, and in accordance with policies compatible with the pattern of federal regulation.

The United States Supreme Court has "repeatedly warned against the dangers of an approach to statutory construction which confines itself to the bare words of a statute, [citations], for 'literalness may strangle meaning.' [Citation]." (Lynch v. Overholser (1962) 369 U.S. 705, 710.) We accept that the FAA contains certain principles of substantive federal law which must be applied, regardless of forum, where federal jurisdiction exists; on that point we are fully in accord with our dissenting colleagues. We simply reject Southland's argument that those principles are so unyielding as to require enforcement of an agreement to arbitrate a dispute over the application of a regulatory statute which a state legislature, in conformity with analogous federal policy, has decided should be left to judicial enforcement.[15]

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15 Southland urges that exclusion of Franchise Investment Law claims from arbitration will lead to duplicative proceedings because franchisees'

III. WAIVER.

Franchisees contend that Southland waived its right to arbitration by delays in asserting it, and by pursuing legal actions which were inconsistent with it. We will separately consider waiver in connection with *Keating*, and with the individual actions.

The law in this area is rather well defined. Arbitration is strongly favored. Courts will closely scrutinize any claims of waiver (Gavlik Const. Co. v. H. F. Campbell Co. (3d Cir. 1975) 526 F.2d 777, 783; Seidman & Seidman v. Wolfson (1975) 50 Cal.App.3d 826, 835; 9 U.S.C. § 3; Code Civ. Proc., § 1281.2, subd. (a)), and " 'indulge every intendment to give effect to such proceedings.' (Pacific Inv. Co. v. Townsend (1976) 58 Cal.App.3d 1, 9.)" (Doers v. Golden Gate Bridge etc. Dist., supra, 23 Cal.3d 180, 189.) Moreover, the burden of proof is "heavy" and rests on the party seeking to establish waiver (Martin Marietta Aluminum, Inc. v. General Elec. Co. (9th Cir. 1978) 586 F.2d 143, 146; General Guar. Ins. Co. v. New Orleans General Agency, Inc. (5th Cir. 1970) 427 F.2d 924, 929, fn. 5) which "is not to be lightly inferred." (Gavlik Const. Co. v. H. F. Campbell Co., supra, 526 F.2d at p. 783; Davis v. Blue Cross of Northern California (1979) 25 Cal.3d 418, 426.)

The trial court here found no waiver. Because the question of waiver is one of fact, we have noted that the "determination of this question, if supported by substantial evidence, is binding on an appellate court. [Citation.] . . . [It is only] in cases where the record before the trial court establishes a lack of waiver as a matter of law, [that] the appellate court may reverse a finding of waiver made by the trial court." (Doers v. Golden Gate Bridge etc. Dist., supra, 23 Cal.3d at p. 185; see Reid Burton Const. v. Carpenters Dist. Council, etc. (10th Cir.

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common law claims of fraud and negligent misrepresentation involve the "same constellation of facts." Under federal law, such considerations may be taken into account in determining the order of proceedings, and even in determining whether common law claims should be decided in a judicial forum. (Sibley v. Tandy Corp., supra, 543 F.2d 540, 543, cert. den. (1977) 434 U.S. 824; Miley v. Oppenheimer & Co., Inc. (1981) 637 F.2d 318.)

1980) 614 F.2d 698, 703, cert. den. (1980) 449 U.S. 824 [adopting a "clearly erroneous" standard of review].)

We have recently acknowledged that while there is no "single test" in establishing waiver, the relevant factors include whether the party seeking arbitration (1) has "previously taken steps inconsistent with an intent to invoke arbitration," (2) "has unreasonably delayed" in seeking arbitration, (3) or has acted in "bad faith" or with "wilful misconduct." (Davis v. Blue Cross of Northern California, supra, 25 Cal.3d at pp. 425-426; see Germany v. River Terminal Railway Company (6th Cir. 1973) 477 F.2d 546, 547.) We have stressed the significance of the presence or absence of prejudice. Waiver does not occur by mere participation in litigation; there must be "judicial *litigation* of the merits of arbitrable issues" (Doers v. Golden Gate Bridge etc. Dist., supra, 23 Cal.3d at p. 188), although "waiver could occur prior to a judgment on the merits if prejudice could be demonstrated" (id., at p. 188, fn. 3). This result is fully consistent with federal cases which have held that "as an abstract exercise in logic it may appear that it is inconsistent for a party to participate in a lawsuit for breach of a contract, and later to ask the court to stay that litigation pending arbitration. Yet the law is clear that such participation, standing alone, does not constitute a waiver [citations], for there is an overriding federal policy favoring arbitration. . . . [M]ere delay in seeking a stay of the proceedings without some resultant prejudice to a party [citation], cannot carry the day." (Carcich v. Rederi A/B Nordie (2d Cir. 1968) 389 F.2d 692, 696; see Shinto Shipping Co. v. Fibrex & Shipping Co., Inc. (9th Cir. 1978) 572 F.2d 1328, 1330.)

Tested by these principles, the record fully supports the trial court's conclusion that there was no waiver in *Keating*. Southland had a legal right to petition for removal of the case to the federal district court; it did so promptly, as the statute requires (28 U.S.C. § 1446(b)); and in its amended pleading it asserted the arbitration agreement as a defense. Prior to remand, the only discovery which took place consisted of an exchange of documents to franchisees' benefit. Upon remand,

Southland moved promptly to compel arbitration.[16] We discern no impropriety on the part of Southland, or prejudice to franchisees, in these brief transactions.

In the remaining four individual actions, namely, *Gouveia*, *Sampson*, *Cheng*, and *Newell*, the trial court granted the motions to arbitrate except as to the Franchise Investment Law claims, and stayed the proceedings pending completion of arbitration. In noting the coordination of the various actions the court observed that "there are matters which would otherwise be arbitrable which are raised for the first time in the second amended complaint." It believed that referring to arbitration only some issues while retaining others might well achieve inconsistent results and would serve no useful purpose. The court also observed that in some cases, separately viewed, "there more than likely would have been found to be a waiver."

Franchisees interpret the foregoing trial court remarks as constituting a holding of waiver. They also contend that the trial court erred in misconstruing the coordination of the proceedings as requiring complete consistency of result between the individual cases. We do not agree. Extensively amended complaints have been filed in each case after the actions had been coordinated at franchisees' request. We cannot say, as a matter of law, that the court erroneously considered the coordinated posture of the cases in finding a lack of waiver of Southland's right to arbitration. Franchisees themselves asserted in their motion for coordination that "[e]ach of the actions for which coordination is sought herein is at the same relative stage of development." Furthermore, the court did not specify in which of the actions a waiver might have appeared, and franchisees' argument that the trial court found a waiver in any individual case is purely speculative.

Moreover, assuming a waiver had occurred as to the charging allegations in the original complaints, such waiver would not extend to issues newly raised. (Cf. Janmort Leas., Inc. v. Econo-Car Intern. (E.D.N.Y. 1979) 475 F.Supp. 1282, 1290.)

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16 It moved also for a change of venue, which was granted by stipulation.

In seeking coordination and amendment of their complaints, franchisees considerably expanded the scope of their pleadings, raising several new causes of action, injecting new factual elements, and refocusing the direction of their claims. We do not suggest that an amendment to a complaint will, per se, nullify a previous, effective waiver of arbitration in every case. Here, however, franchisees directed a newly concerted attack, evidenced by the filing of amended complaints and the motion to coordinate. This sufficiently changed the proceedings, when viewed in their entirety, to permit the trial court to find a lack of waiver of the right to arbitrate the closely interrelated and interdependent claims.

We are unable to accept franchisees' argument that any waiver occurred because of Southland's litigation-related activities in *Gouveia, Sampson, Cheng,* and *Newell.* As with similar arguments advanced with reference to the *Keating* complaint, Southland's delay in seeking arbitration of the other complaints, its filing of counterclaims and actions for unlawful detainer, and its participation in discovery did not require a finding of waiver. (Doers v. Golden Gate Bridge etc. Dist., supra, 23 Cal.3d at p. 188; Carcich v. Rederi A/B Nordie, supra, 389 F.2d at p. 696.) Here, Southland raised arbitration as an affirmative defense in its answers to each of the original complaints except in *Gouveia.* As previously noted, "it is the judicial *litigation* of the merits of arbitrable disputes which waives a party's right to arbitration" (Doers v. Golden Gate Bridge etc. Dist., supra, 23 Cal.3d at p. 188), and the burden is on franchisees to show that the trial court's determination was not supported by the facts. (See, e.g., Hart v. Orion Insurance Company (10th Cir. 1971) 453 F.2d 1358, 1361.)

Because of the mandatory nature of Code of Civil Procedure section 426.30 requiring that any related cause of action be alleged, no waiver arose by reason of the filing of the cross-complaints. As to the unlawful detainer causes of action, the agreements themselves specifically provide that a demand for arbitration "shall not operate to stay. . . the right of 7-Eleven to take possession of the Lease Property in accordance with the

Agreement." The contract contemplated that arbitration and litigation of the right to possession would proceed simultaneously.

Again, we find most significance in the lack of any prejudice demonstrated by franchisees in *Gouveia, Sampson, Cheng,* and *Newell.* While Southland participated in discovery in the individual actions before demanding arbitration, the trial court expressly conditioned its order to compel arbitration on Southland's agreement either to abstain from the use of further discovery or to extend equally extensive discovery to franchisees. Moreover, the discovery was reciprocal; for example, franchisees' petition for coordination indicated that evidence of Southland's bookkeeping practices had already been obtained and was relevant to all of the individual actions.

Neither side had completed its discovery, and Southland asserted, without refutation, that the filing of the new complaints significantly raised new issues requiring further discovery should the cases go to trial. The condition imposed by the trial court on its order for arbitration, however, prevented Southland from taking advantage of any previously discovered information.

Our function is to determine whether the trial court's finding of no waiver is supported by substantial evidence. Franchisees have not made specific claims of prejudice. Nor have we been supplied with any record of the discovery proceedings already undertaken by which we could independently assess such claims if made.

Accordingly, we cannot conclude that the trial court erred in finding no waiver and in ordering arbitration.

IV. Class Arbitration.

The trial court, in ordering arbitration, did not expressly rule upon the motions in *Keating* and *Battersby* for class certification. Franchisees contend that if arbitration is to proceed the trial court should be instructed to determine the preliminary issues regarding class certification so that it may proceed on a classwide basis. This contention requires us to

examine the special problems of unfair advantage which may appear in an adhesion setting when individual arbitration agreements are invoked to block an otherwise appropriate class action.[17]

This court has repeatedly emphasized the importance of the class action device for vindicating rights asserted by large groups of persons. We have observed that the class suit "both eliminates the possibility of repetitious litigation and provides small claimants with a method of obtaining redress for claims which would otherwise be too small to warrant individual litigation. [Citation.]" (Richmond v. Dart Industries, Inc. (1981) 29 Cal.3d 462, 469.) Denial of a class action in cases where it is appropriate may have the effect of allowing an unscrupulous wrongdoer to "retain[] the benefits of its wrongful conduct." (Vasquez v. Superior Court (1971) 4 Cal.3d 800, 808.)[18] And, as we noted in *LaSala* v. *American Sav. & Loan Assn.* (1971) 5 Cal.3d 864, 877: "Controversies involving widely used contracts of adhesion present ideal cases for class adjudication; the contracts are uniform, the same principles of interpretation apply to each contract, and all members of the class will share a common interest in the interpretation of an agreement to which each is a party."

If the right to a classwide proceeding could be automatically eliminated in relationships governed by adhesion contracts through the inclusion of a provision for arbitration, the potential for undercutting these class action principles, and for chilling the effective protection of interests common to a

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17 We assume, for purposes of this analysis, that *Keating* and *Battersby* would be maintainable as class actions under established principles, but we intimate no opinion as to whether that is, in fact, the case. That will be an issue for the trial court upon remand.

18 Federal law is in accord. (See, e.g., Weeks v. Bareco Oil Co. (7th Cir. 1941) 125 F.2d 84, 90 ("To permit the defendants to contest liability with each claimant in a single, separate suit, would, in many cases give defendants an advantage which would be almost equivalent to closing the door of justice to all small claimants"); Moscarelli v. Stamm (E.D.N.Y. 1968) 288 F.Supp. 453, 461.)

group, would be substantial. Arbitration proceedings may well provide certain offsetting advantages through savings of time and expense; but, depending upon the nature of the issues and the evidence to be presented, it is at least doubtful that such advantages could compensate for the unfairness inherent in forcing hundreds or perhaps thousands, of individuals asserting claims involving common issues of fact and law to litigate them in separate proceedings against a party with vastly superior resources. Because the principles of res judicata and collateral estoppel do not apply in arbitration proceedings, any issue resolved against a party such as Southland in one arbitration proceeding would have to be decided anew in a subsequent arbitration, resulting in needless duplication and the potential for inconsistent awards. And while arbitration ideally takes place outside the judicial arena, it would be naive to assume, in such a situation, that courts would not be called upon to determine issues ancillary to the arbitration proceedings. The effect would be to place upon the parties, and upon the courts, many of the burdens which the class action device was designed to avoid.

It is common knowledge that arbitration clauses frequently appear in standardized contracts of adhesion. A primary consideration which has led courts to uphold such clauses, despite the adhesive nature of the contract, is the belief that arbitration is not oppressive and does not defeat the reasonable expectations of the parties. (Madden v. Kaiser Foundation Hospitals, supra, 17 Cal.3d 699, 710, 712.) If, however, an arbitration clause may be used to insulate the drafter of an adhesive contract from any form of class proceeding, effectively foreclosing many individual claims, it may well be oppressive and may defeat the expectations of the nondrafting party.

One possible solution to this dilemma would be to hold that arbitration agreements contained in contracts of adhesion may not operate to stay properly maintainable class actions. (See Harris v. Shearson Hayden Stone, Inc. (1981) 441 N.Y.S.2d 70, 76-79 (dis. opns.); cf. Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc. (1971) 20 Cal.App.3d 668, 672; Vernon v. Drexel

Burnham & Co. (1975) 52 Cal.App.3d 706.) The statutes and public policy supportive of arbitration require, however, that this result be avoided if means are available to give expression to the basic arbitration commitment of the parties. (Graham v. Scissor-Tail, Inc., supra, 28 Cal.3d 807, 831.) We turn our attention, therefore, to the solution offered by franchisees: that the arbitration itself proceed on a classwide basis.

There is, as the parties acknowledge, an absence of direct authority either supporting or rejecting such a procedure. Analogous authority exists, however, with respect to the consolidation of arbitration proceedings involving a dispute which concerns several parties each of whom has an agreement with one or more of the others to arbitrate the dispute. "Although the [Federal Arbitration] Act does not specifically provide for consolidated arbitrations, courts have frequently ordered consolidated arbitration proceedings when the 'interests of justice' so require, either because the issues in dispute are substantially the same and/or because a substantial right might be prejudiced if separate arbitration proceedings are conducted." (Matter of Czarnikow-Rionda Co., Inc. (S.D.N.Y. 1981) 512 F.Supp. 1308, 1309.) Indeed, the Second Circuit has opined that "the liberal purposes of the Federal Arbitration Act clearly require that this act be interpreted so as to permit and even encourage the consolidation of arbitration proceedings in proper cases." (Compania Espanola de Pet., S.A. v. Nereus Ship. (2d Cir. 1975) 527 F.2d 966, 975, cert. den. (1976) 426 U.S. 936; see also, Marine Trading Ltd. v. Ore International Corp. (S.D.N.Y. 1977) 432 F.Supp. 683; Robinson v. Warner (D.C.R.I. 1974) 370 F.Supp. 828.)

Federal courts, in ordering consolidation of arbitration proceedings in these cases, have relied upon rule 81(a)(3) of the Federal Rules of Civil Procedure, which states that the federal rules apply to certain statutes, including the FAA, "only to the extent that matters of procedure are not provided for in those statutes." Thus, rule 42(a), which provides for consolidation of related proceedings, is deemed to apply. Analogous reasoning would support reliance on rule 23, the class action rule, as a

basis for ordering classwide arbitrations when the interests of justice so require.

A number of state courts also support consolidation of arbitration proceedings, even in the absence of express statutory authority. New York courts take the position that "jurisdiction to enforce contracts to arbitrate imports power to regulate the method of enforcement." (Chariot Textiles Corp. v. Wannalancit Textile Co. (1964) 250 N.Y.S.2d 493, 495 (dis. opn.), revd. on dis. opn. (1966) 275 N.Y.S.2d 382 [221 N.E.2d 913]; see also In re Vigo Steamship Corporation (1970) 257 N.E.2d 624, cert. den. *sub nom.*, Frederick Snare Corp. v. Vigo Steamship Corp. (1970) 400 U.S. 819; accord: Grover-Dimond Assoc. v. American Arbitration Ass'n (Minn. 1973) 211 N.W.2d 787; see also, Exber, Inc. v. Sletten Construction Company (Nev. 1976) 558 P.2d 517; James Stewart Polshek, etc. v. Bergen Iron Wks. (N.J. 1976) 362 A.2d 63; Episcopal Housing Corp. v. Federal Ins. Co. (S.C. 1979) 255 S.E.2d 451; contra: Stop & Shop Companies, Inc. v. Gilbane Building Co. (Mass. 1973) 304 N.E.2d 429; J. Brodie & Son, Inc. v. George A. Fuller Company (Mich. 1969) 167 N.W.2d 886; see generally, Annot., Consolidation of Arbitration Proceedings, 64 A.L.R.3d 528, 529.) In California, consolidation in certain cases is expressly authorized by statute. (Code Civ. Proc., § 1281.3.)[19]

Consolidated arbitration often involves a tripartite relationship in which the parties in dispute each have a contract with a third party, but not with each other. Each contract may provide

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19 Section 1281.3 was added in 1978 (Stats. 1978, ch. 260, § 2), apparently in response to a Court of Appeal decision holding that courts of this state lacked authority to order consolidation of arbitration proceedings. (Atlas Plastering, Inc. v. Superior Court (1977) 72 Cal.App.3d 63.) The section permits consolidation of separate arbitration proceedings when "(1) Separate arbitration agreements or proceedings exist between the same parties; or one party is a party to a separate arbitration agreement or proceeding with a third party; and (2) The disputes arise from the same transactions or series of related transactions; and (3) There is common issue or issues of law or fact creating the possibility of conflicting rulings by more than one arbitrator or panel of arbitrators."

a different procedure for arbitration, or a different method of selecting the arbitrator. Federal courts have held that a court "can mold the method of selection and the number of arbitrators to implement the consolidated proceedings." (Matter of Czarnikow-Rionda Co., Inc., supra, 512 F.Supp. at p. 1309.) Similarly, Code of Civil Procedure section 1281.3 provides that consolidated arbitration proceedings may be ordered inter alia, where "one party is a party to a separate arbitration agreement or proceeding with a third party," and that if the agreements do not mesh in their description of procedure, a court has authority to appoint an arbitrator, and to "resolve [conflicts among the agreements] and determine the rights and duties of the various parties to achieve substantial justice under all the circumstances." Thus, a party may be forced into a coordinated arbitration proceeding in a dispute with a party with whom he has no agreement, before an arbitrator he had no voice in selecting and by a procedure he did not agree to.

In these respects, an order for classwide arbitration in an adhesion context would call for considerably less intrusion upon the contractual aspects of the relationship. The members of a class subject to classwide arbitration would all be parties to an agreement with the party against whom their claim is asserted; each of those agreements would contain substantially the same arbitration provision; and if any of the members of the class were dissatisfied with the class representative, or with the choice of arbitrator, or for any other reason would prefer to arbitrate on their own, they would be free to opt out and do so. Moreover, the interests of justice that would be served by ordering classwide arbitration are likely to be even more substantial in some cases than the interests that are thought to justify consolidation. It is unlikely that the state Legislature in adopting the amendment to the Arbitration Act authorizing consolidation of arbitration proceedings, intended to preclude a court from ordering classwide arbitration in an appropriate case. We conclude that a court is not without authority to do so.

Without doubt a judicially ordered classwide arbitration would entail a greater degree of judicial involvement than is

normally associated with arbitration, ideally "a complete proceeding, without resort to court facilities." (East San Bernardino County Water Dist. v. City of San Bernardino (1973) 33 Cal.App.3d 942, 950.) The court would have to make initial determinations regarding certification and notice to the class, and if classwide arbitration proceeds it may be called upon to exercise a measure of external supervision in order to safeguard the rights of absent class members to adequate representation and in the event of dismissal or settlement. A good deal of care, and ingenuity, would be required to avoid judicial intrusion upon the merits of the dispute, or upon the conduct of the proceedings themselves and to minimize complexity, costs, or delay. (See *Class Wide Arbitration: Efficient Adjudication or Procedural Quagmire*? (1981) 67 Va.L.Rev. 789.)

An adhesion contract is not a normal arbitration setting, however, and what is at stake is not some abstract institutional interest but the interests of the affected parties. Classwide arbitration, as Sir Winston Churchill said of democracy, must be evaluated, not in relation to some ideal but in relation to its alternatives. If the alternative in a case of this sort is to force hundreds of individual franchisees each to litigate its cause with Southland in a separate arbitral forum, then the prospect of classwide arbitration, for all its difficulties, may offer a better, more efficient, and fairer solution. Where that is so, and gross unfairness would result from the denial of opportunity to proceed on a classwide basis, then an order structuring arbitration on that basis would be justified.

Whether such an order would be justified in a case of this sort is a question appropriately left to the discretion of the trial court. In making that determination, the trial court would be called upon to consider, not only the factors normally relevant to class certification, but the special characteristics of arbitration as well, including the impact upon an arbitration proceeding of whatever court supervision might be required, and the availability of consolidation as an alternative means of assuring fairness. Whether classwide proceedings would prejudice the legitimate interests of the party which drafted the adhesion agreement must also be considered, and that party

should be given the option of remaining in court rather than submitting to classwide arbitration.

In this case, the trial court did not consider the franchisees' request for classwide arbitration at all, and a fortiori did not consider the facts which we have found to be relevant. Since we are unable to make the determination on this record as a matter of law, the case will be remanded to the trial court on this issue.

The order of the trial court is reversed and the cause is remanded for further proceedings consistent with the opinion herein. In light of our opinion, the petition for writ of prohibition or mandate is denied. Each party to bear their own costs.

*GRODIN, J.

WE CONCUR:

BIRD, C.J.
NEWMAN, J.
REYNOSO, J.

CONCURRING AND DISSENTING OPINION BY RICHARDSON, J.

I concur with the majority's conclusions that the arbitration agreement is enforceable and that Southland did not waive its right to arbitration. I respectfully dissent, however, from the majority's further holdings that the Franchise Investment Law claims are not subject to arbitration and that class action arbitration is an available valid remedy.

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* Assigned by the Chairperson of the Judicial Council.

A. ARBITRABILITY OF THE FRANCHISE INVESTMENT LAW CLAIMS

Contrary to the majority, I believe that the state cannot immunize certain civil actions from application of the Federal Arbitration Act merely by fashioning, after the Federal Securities Act, a statute regulating franchise investments.

The United States Supreme Court in Wilko v. Swan (1953) 346 U.S. 427, held that an arbitration clause contained in a margin agreement was invalid as a forbidden "stipulation" under section 14 of the federal Securities Act of 1933. (15 U.S.C. § 77n.) In so holding, the court observed that two statutory policies were invoked: (1) the Federal Arbitration Act's emphasis on "the need for avoiding the delay and expense of litigation" (*id.*, at p. 431, fn. omitted); and (2) the Securities Act's purpose to protect investors by requiring "full and fair disclosure . . . and to prevent fraud." (*Ibid.*) The high court stressed that "[w]hen the security buyer, prior to any violation of the Securities Act, waives his right to sue in courts, he gives up more than would a participant in other business transactions. The security buyer has a wider choice of courts and venue. He thus surrenders one of the advantages the Act gives him and surrenders it at a time when he is less able to judge the weight of the handicap the Securities Act places upon his adversary." (*Id.*, at p. 435.) In measuring the force of the two policies, the *Wilko* court thus was required to balance two *federal* statutes, the Arbitration and the Securities Acts.

The *Wilko* court identified one important factor in the weighing process, namely, the existence of 15 United States Code section 77v, which establishes an unusually liberal venue provision for Securities Act litigation. This emphasis on venue was subsequently repeated in Scherk v. Alberto-Culver Co. (1974) 417 U.S. 506, in which the high court *declined* to invalidate an arbitration clause in a controversy between foreign and domestic parties concerning an alleged violation of the 1934 Securities Exchange Act. The *Scherk* court specifically emphasized that the 1934 act's venue provision (15 U.S.C. § 78aa) "significantly restrict[s] the plaintiff's choice of

forum" in contrast to section 77v, upon which the court "in particular" relied in *Wilko* v. *Swan*. (*Id.*, at p. 514, fn. omitted.)

In contrast, the case before us concerns a *state* statute which is contrary to the *federal* law. The *Wilko* reasoning in balancing between two federal statutes of equal stature thus is not required here. Moreover, unlike the Securities Act of 1933, the state Franchise Investment Law at issue here does not contain a liberal venue provision comparable to that relied on in *Wilko*. Thus, under the California statute an investor who consents to arbitration, thereby waiving the right to sue, does *not* forego more than other similarly situated parties to routine business contracts or transactions.

No different result is mandated by section 31512 of the Corporations Code, which provides that "Any condition, stipulation or provision purporting to bind any person acquiring any franchise to waive compliance with any provisions of this law or any rule or order hereunder is void." Even if the Legislature had intended that this statute be interpreted according to the principles of *Wilko* v. *Swan*, the section nonetheless impermissibly conflicts with the Federal Arbitration Act. Section 31512 is therefore void under the supremacy clause (U.S. Const., art. VI, § 2) to the extent that it purports to restrict otherwise permissible arbitration in actions, as here, involving interstate commerce.

In reaching its conclusion that application of the Federal Arbitration Act here is not required, the majority wholly ignores a substantial line of very respectable authority. These cases, as I now develop, hold that in enacting the Federal Arbitration Act, Congress created *national substantive law*, which is binding on state courts even in the absence of federal jurisdiction.

In 1959, the United States Court of Appeals for the Second Circuit succinctly expressed the general principle. "We think it is reasonably clear that the Congress intended by the Arbitration Act to create *a new body of federal substantive law* affecting the validity and interpretation of arbitration agreements." (Robert Lawrence Company v. Devonshire Fabrics,

Inc. (2d Cir. 1959) 271 F.2d 402, 406, cert. dism. (1960) 364 U.S. 801, italics added.) The *Lawrence* court observed: "To be sure much of the Act is purely procedural in character and is intended to be applicable only in the federal courts. But Section 2 declaring that arbitration agreements affecting commerce or maritime affairs are 'valid, irrevocable, and enforceable' goes beyond this point and must mean that arbitration agreements of this character, previously held by state law to be invalid, revocable, or unenforceable are now made 'valid, irrevocable, and enforceable.' *This is a declaration of national law equally applicable in state or federal courts.*" (*Id.*, at p. 407, italics added.)

The United States Supreme Court has acknowledged the *Lawrence* holding only in one instance, where it merely noted that the Court of Appeals in the case it was then considering had relied upon the *Lawrence* notion of "national substantive law" to hold that "a claim of fraud in the inducement of the contract generally—as opposed to the arbitration clause itself—is for the arbitrators and not for the courts . . . ." (Prima Paint v. Flood & Conklin (1967) 388 U.S. 396, 399-400.) The high tribunal then affirmed the decision below, "albeit for somewhat different reasons." (*Ibid.*) Thus the Supreme Court has never rejected the long standing doctrine that the Arbitration Act created national substantive law applicable in appropriate circumstances in state courts.

The great majority of lower federal and state courts has continued to adhere to the *Lawrence* holding. (See Annot. (1979) 95 A.L.R.3d 1145, 1151-1161.) A recent expression of this principle is contained in In re Mercury Const. Corp. (4th Cir. 1981) 656 F.2d 933 (en banc) (cert. granted *sub nom.* Moses A. Cone Memorial Hospital v. Mercury Const. Corp. (1982) __ U.S. __ [102 S.Ct. 1426]) (three questions were presented in the petition for certiorari; none specifically concerns the scope of the Arbitration Act although one involves the district court's discretion to stay its proceedings pending resolution of identical issues in a state court action involving identical parties). In discussing the application of the Federal Arbitration Act to state and federal actions the Fourth Circuit

noted: "By its express language the Federal Act applies where there is '[a] written provision . . . in a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract . . . .' 9 U.S.C. § 2. The constitutional validity of such an Act is found in the incontestable federal control over interstate commerce. Prima Paint v. Flood & Conklin, 388 U.S. 395, 405 . . . . The Act, however, does not include language conferring independent federal jurisdiction over an action thereunder. In order for a plaintiff to assert rights under it in a federal forum, he must establish an independent jurisdictional basis, such as diversity. [Citations.] But if, assuming diversity of the parties, the action meets the jurisdictional requirements of the Act, that action is enforceable in the state courts as well as in federal courts but *in either event it is governed by the federal substantive law developed in connection with the federal Act and not by state law*. E.C. Ernst, Inc. v. Manhattan Const. Co., 551 F.2d 1026, 1040 (5th Cir. 1977) (any questions under the Act are matters of 'federal law'); Robert Lawrence Co. v. Devonshire Fabrics, Inc., supra, 271 F.2d at 406; Pathman Const. Co. v. Knox County Hospital Ass'n., 164 Ind. App. 121, 326 N.E.2d 844, 851 (1975); Episcopal Housing Corp. v. Federal Ins. Co., 269 S.C. 631, 636, 239 S.E.2d 647 (1977)." (*Id.*, at p. 938, italics in original, fn. omitted.) As described in *Lawrence*, Congress in enacting the arbitration act sought to counteract the hostility of courts and judges to arbitration agreements and to "make the benefits of arbitration generally available to the business world." (271 F.2d at pp. 406-407; see Prima Paint v. Flood & Conklin, supra, 388 U.S. at p. 405 [Congress "plainly" had power to legislate over arbitration].)

Despite the majority's recognition of the large body of law holding that the act is applicable in state courts in appropriate cases, my colleagues seek to create, judicially, an exception for certain state regulatory practices based on some conclusion that Congress did not intend to preempt the area of franchise regulation. The majority, however, fails to acknowledge that Congress has indeed preempted the field of arbitration as applied to *any* contract in interstate commerce to the extent

that title 9 of the United States Code applies. No one has urged before us that there is any basis other than the state regulatory statute upon which to deny application of the Federal Arbitration Act to the contract at issue.

In addition to encouraging the enforcement of arbitration agreements, the Arbitration Act also restricts the benefits of the usually disfavored practice of forum shopping. As the majority recognizes, the likely explanation for the federal district court's remand of the action here was that complete diversity did not exist because of the presence of California defendants. Had those defendants not been named, which was, of course, well within a franchisee's power to choose, the answer would have been easy. The action could have been readily removed to the federal courts on the basis of diversity and the Arbitration Act unquestionably would have applied. It will thus be seen that the majority implicitly makes the existence or nonexistence of federal jurisdiction the determinative factor in the enforcement of the arbitration clause rather than the existence of a "transaction involving commerce . . . ." In so concluding, the majority ignores the critical distinction which exists in the Arbitration Act between the conferral of federal jurisdiction and the creation of federal substantive law applicable in state courts. This promotes forum shopping.

In a similar context, the court in In re Mercury Const. Corp., supra, specifically observed that, "The addition of the Architect as a party defendant might prevent removal of the state action . . . but it certainly could not frustrate Mercury's plain, indisputable right to an arbitration of *its* dispute with the Hospital." (636 F.2d at p. 942.) The Arbitration Act, construed as national substantive law binding on both federal and state courts, advances consistency.

Finally, I find it significant that sister courts which have specifically considered state statutes analogous to the one before us have found that the Arbitration Act prevails over various state attempts to limit its reach. Thus, in Allison v. Medicab (Wash. 1979) 597 P.2d 380, the Washington Supreme Court reviewed a claim that an arbitration clause in a franchise agreement was invalid under the state's franchise act which

gave to the state courts jurisdiction for causes of action based on violations of the state act. Finding that interstate commerce was involved, the *Allison* court rejected the argument that *Wilko* v. *Swan*, supra, applied to a conflict between a state franchising act and the Federal Arbitration Act. The *Allison* court instead adopted the weight of authority rule applying the federal act in the face of a contrary state law (*id.*, at p. 382), concluding that "the *supremacy clause of the federal constitution must prevail and thus the Federal Arbitration Act requires enforcement of the arbitration clause in the franchise agreement despite the judicial remedies afforded by the Franchise Investment Protection Act.*" (597 P.2d at pp. 382-383, italics added.)

In similar fashion, in Network Cinema Corporation v. Glassburn (S.D.N.Y. 1973) 357 F.Supp. 169, the federal district court granted an order staying proceedings in a Kansas state court pending arbitration of a dispute between franchisor and franchisee. The Kansas court had held that the arbitration clause signed by the parties was not enforceable under state law. The federal court nonetheless found that it was empowered to stay state proceedings "when the dispute in question has been found by the court to be subject to the arbitration provisions of 9 U.S.C. § 2." (*Id.*, at p. 172, see also Main v. Merrill Lynch, Pierce, Fenner & Smith, Inc. (1977) 67 Cal.App.3d 19, 23-25, and cases cited therein [" 'The Federal Arbitration Act, declaring arbitration agreement affecting [interstate] commerce or maritime affairs to be valid, enforceable, and irrevocable, is a declaration of national law equally applicable in state or federal courts' "]; Fite & Warmath Const. Co., Inc. v. MYS Corp. (Ky. 1977) 559 S.W.2d 729, 734-735.)

Finally, in Barron v. Tastee-Freez Intern., Inc. (E.D.Wisc. 1980) 482 F.Supp. 1213, the federal district court considered the enforcement of an arbitration clause in the face of a state statute analogous to section 31512, which it characterized as similar to 15 United States Code section 77n. (482 F.Supp. at pp. 1215-1216.) The court felt compelled by the Federal Arbitration Act "to render void any effort made by a state to protect the remedies of the franchise investors" contrary to the

federal act in cases in which the transactions related to interstate commerce. (*Id.*, at p. 1217; see also Guinness-Harp Corp. v. Jos. Schlitz Brewing (2d Cir. 1980) 613 F.2d 468, 472.) "The policy embodied in Title 9 U.S.C. . . . does not depend for its enforceability on the residence of the parties to a contract but rather on the nature of the contract." (Barron v. Tastee-Freez Intern., Inc., supra, 482 F.Supp. at p. 1217.)

The majority attempts to remove a state regulatory statute from the purview of the Federal Arbitration Act in cases involving interstate commerce. In my opinion, its chances of surviving federal review are very dubious. I believe section 31512 is void insofar as it attempts to restrict application of the federal act. Contrary to the majority's assertion, the issue is not the preemption of the field of franchise investment regulation, but rather the clear language of the federal act and the subsequent state and federal court interpretations which consistently demonstrate that the Federal Arbitration Act applies to all claims arising out of transactions in interstate commerce. "Because the United States Arbitration Act is a national substantive law that supplants state arbitration laws, *a state court is bound to apply the act* if the statutory requisites are present; . . ." (Merrill Lynch, Pierce, Fenner, etc. v. Haydu (5th Cir. 1981) 637 F.2d 391, 395, italics added.) As the majority first acknowledges and then ignores, "The Franchise Agreements . . . involve interstate commerce and fall within the ambit of the Federal Arbitration Act." (*Ante*, p. 4a.) The conclusion that the federal act must prevail is logical, consistent and supported by case law, statutory language, and congressional history. California remains one of the United States, and national substantive law must be applied by us in appropriate cases.

B. Class Action Arbitration

The majority also concludes that class action arbitration may be an appropriate procedure and has remanded the case for determination by the trial court. In the absence of either statutory or contractual authority, I disagree with its holding.

Arbitration is a matter of agreement. It is consensual, being an integral part of the contract. In such situations we have said that the parties "may freely delineate the area of its application." (O'Malley v. Wilshire Oil Co. (1963) 59 Cal.2d 482, 490; see Reid Burton Const. v. Carpenters Dist. Council, etc. (10th Cir. 1980) 614 F.2d 698, 702, cert. den. __ U.S. __, 101 S.Ct. 85.) As a general principle, in considering contract enforcement, "there is perhaps no higher public policy than to uphold and give effect to contracts validly entered into and legally permissible in subject matter." (Vernon v. Drexel Burnham & Co. (1975) 52 Cal.App.3d 706, 716.)

In the present case, the contracts of the parties do not provide for class arbitration, nor have the parties subsequently agreed thereto. No statute authorizes a court to order arbitration on a class-wide basis. Nonetheless, the majority concludes that such a procedure is possible in order to prevent repetitive arbitration and to avoid "effectively foreclosing individual claims" in instances where the arbitration contract "may be used to insulate the drafter of an adhesion contract from any form of class proceeding." (*Ante*, p. 25a.)

A recent New York case examined the propriety of the class action device used in arbitration. Harris v. Shearson Hayden Stone, Inc. (N.Y.App. 1981) 441 N.Y.S.2d 70, weighed the policies favoring class actions and arbitration and concluded that the filing of a class action alleging a broker's breach of fiduciary duty would not permit avoidance of an agreement to arbitrate. The agreement was contained in a "customer's agreement" which the brokerage firm required all customers to sign. Citing the consistent holdings of our Courts of Appeal in Vernon v. Drexel Burnham & Co., supra, 52 Cal.App.3d 706, 716, and Frame v. Merrill Lynch, Pierce, Fenner & Smith (1971) 20 Cal.App.3d 668, 672, the New York court held that "maintenance of a class action here by assertion of a claim for which a forum is provided elsewhere, would defeat the aim of arbitration, and undercut an avowed purpose of the class action itself—the 'conservation of judicial effort.'" (441 N.Y.S.2d at p. 76.)

In dissent, Justice Bloom urged that the conflict should be resolved in favor of the class action. Even he, however, expressly rejected the idea of a "class arbitration" saying, "Nor is it an answer to assert that the dispute between plaintiffs and Shearson may be proceeded with as a 'class arbitration.' Arbitration does not lend itself to the many subsidiary proceedings incident to an ongoing class action, e.g. determination of whether class action status should be granted, definition of the class, determination of the nature and kind of notice and by whom it should be sent, provision for opting out, etc. In sum, if the matter is to proceed in arbitration it must proceed as an individual claim." (*Id.*, at p. 79; cf. Coleman v. National Movie-Dine, Inc. (E.D.Pa. 1978) 449 F.Supp. 945, 948 ["Arbitration should not be foreclosed simply by adding persons to a civil action who are not parties to the arbitration agreement because such an inclusion would thwart the federal policy in favor of arbitrations. (Citations.)"].) Thus in weighing the policies behind class actions and arbitration, other courts have found that class actions will not prevail where there is an individual arbitration agreement.

In addition to the concerns mentioned by Justice Bloom, other factors belie franchisees' assertion that class certification would be only a "preliminary" issue. For example, a court, in determining whether class proceedings are appropriate, must be satisfied that there is a "community of interest"; i.e., that common issues predominate over individual issues. (See Code Civ. Proc., § 382; City of San Jose v. Superior Court (1974) 12 Cal.3d 447, 459-460; Fed. Rules Civ. Proc., rule 23, 28 U.S.C.) In determining whether a "community of interest" exists, a court must carefully evaluate the nature of the proof that will be presented by the parties (*City of San Jose,* supra, at p. 460; Abercrombie v. Lum's Inc. (S.D.Fla. 1972) 345 F.Supp. 387, 390), and the parties are likely to devote extensive resources to developing the facts and arguments fully in regard to the usually complex certification issues. (See, e.g., Chance v. Superior Court (1962) 58 Cal.2d 275, 282-287; Blackie v. Barrack (9th Cir. 1975) 524 F.2d 891, 900-901.)

Moreover, class action procedures would interfere with the expeditious resolution of the claims. After certification of a class, the court must notify class members of the existence of the suit so that they will have the opportunity to "opt out." (Fed. Rules Civ. Proc., rule 23(c), 28 U.S.C.) Because of the due process safeguards required to keep class members apprised of the course of the litigation, substantial judicial involvement by the court will be required to monitor the progress of the arbitration and potentially will undermine the arbitrator's discretion. In fact, the court's due process responsibilities include the duty to "undertake a stringent and continuing examination of the adequacy of representation by the named class representative at all stages of the litigation." (Nat. Assn. of Reg. Med. Programs, Inc. v. Mathews (D.C.Cir. 1976) 551 F.2d 340, 344, cert. den. 431 U.S. 954.)

Yet another consideration arises from the fact that unlike settlements reached through arbitration, which are ordinarily not subject to court review on either procedural issues or the merits (see Barrett v. Manuf. Ry. Co. (8th Cir. 1972) 453 F.2d 1305, 1307), a class action settlement normally does not become final without court approval. (La Sala v. Am. S. & L. Assn. (1971) 5 Cal.3d 864, 872; Fed. Rules Civ. Proc., rule 23(e), 28 U.S.C.; In re General Motors Corp. Engine Interchange Litig. (7th Cir. 1979) 594 F.2d 1106, 1124, cert. den. 444 U.S. 870.) The court must review the entire proceedings to determine if the settlement was fair, reasonable, and adequate in light of the strength of each party's case (Marshall v. Holiday Magic, Inc., (9th Cir. 1977) 550 F.2d 1173, 1178-1179), and take evidence on any substantial objection to the proposed settlement brought by any class member. (Mandujano v. Basic Vegetable Products, Inc. (9th Cir. 1976) 541 F.2d 832, 835-836.)

Finally, the normally "informal" nature of arbitration requires no transcripts. Arbitrators generally need not explain the basis for their decision. (Bernhardt v. Polygraphic Co. of America (1956) 350 U.S. 198, 203-204, and fn. 4.) The absence of a record further complicates the use of class proceedings, because without a record a court may have difficulty in applying an arbitrator's decision to all class members, since it

could not determine whether the arbitrator's judgment was applicable to each member of the class, or based on equities applicable only to the individual claimant. Similarly, objection to settlements would be difficult to assess.

In addition, arbitrators, of course, are not necessarily either lawyers or judges. Requiring the administration of complex class procedures during arbitration may either make lay experts unavailable as arbitrators as a practical matter, or result in intrusive judicial participation and supervision.

In summary, class procedures would tend to make arbitration inefficient instead of efficient, lengthy instead of expeditious, and procedural instead of informal. " 'An arbitration proceeding is, except in specified particulars, outside the court realm and jurisdiction—deliberately so taken out of the court by choice and commitment of the parties. Arbitration is subject to its own rules and practices at variance with court proceedings. It is supposed to be a complete proceeding, without resort to court facilities . . . . It would be generally incompatible with the nature and scope of arbitration to allow a shift to the court forum . . . .' (*Application of Katz*, 3 App.Div.2d 238, . . .)" (East San Bernardino County Water Dist. v. City of San Bernardino (1973) 33 Cal.App.3d 942, 950.)

In my view, because of the complications resulting from continued judicial monitoring, the imposition of class action procedures on the arbitration process would be self-defeating.

Nonetheless, by analogy to consolidated arbitration proceedings, the majority insists that *class arbitration* is an available remedy. However, several factors make this analogy less than compelling. In Atlas Plastering, Inc. v. Superior Court (1977) 72 Cal.App.3d 63, Atlas, a general contractor, sought to consolidate arbitration proceedings between itself and several subcontractors, each of whom had entered into identical arbitration agreements with Atlas. The *Atlas* court held that, because the parties had not agreed to consolidated proceedings and because consolidation would deprive the individual subcontractors of their right to choose an arbitrator in the manner set forth in the arbitration agreement, the court lacked the

power to order consolidated proceedings. (Code Civ. Proc., § 1281.6.) When *Atlas* was decided, no statute authorized a court to order consolidation of arbitrations.

Following the decision in *Atlas*, the Legislature enacted Code of Civil Procedure section 1281.3 which specifically authorizes consolidated arbitration at the court's discretion under certain circumstances. This section was relied upon in Conejo Valley Unified School Dist. v. William Blurock & Partners, Inc. (1980) 111 Cal.App.3d 983, in which a party to an arbitration agreement was compelled to arbitrate his claim in consolidated proceedings despite the fact that the agreements contained conflicting provisions for choosing an arbitrator. The *Conejo* court held that section 1281.3 did not create substantive rights, but was a procedural statute and that therefore no constitutional bar to its retroactive application existed.

Unlike the *Conejo* situation, there is no state statute which permits a court to order arbitration proceedings on a class-wide basis when the contractual arrangement of the parties does not authorize it. The Legislature examined the specific problems of related arbitration proceedings when it permitted the consolidation of arbitration. After scrutinizing these problems the Legislature declined to provide for class arbitration.

Nor, as the majority concedes, is there any federal authority for class arbitration. Although federal courts have ordered consolidated arbitration under the authority of rule 42(a) of the Federal Rules of Civil Procedure, the courts have attempted to assure each party the right to select an arbitrator and to express their individual views. (See, e.g., Compania Espanola de Pet., S.A. v. Nereus Ship. (2d Cir. 1975) 527 F.2d 966, 974-975, cert. den. (1976) 426 U.S. 936; Marine Trading Ltd. v. Ore Intern. Corp. (S.D.N.Y. 1977) 432 F.Supp. 683, 685; Robinson v. Warner (D.R.I. 1974) 370 F.Supp. 828, 829.) In fact, the issue of the application of *consolidation* to arbitration proceedings is not a settled matter in the federal courts. (See Gavlik Construction Co. v. H.F. Campbell Co. (W.D.Pa. 1975) 389 F.Supp. 551, 556, revd. on other grounds (3d Cir.) 526 F.2d 777; see also Robinson v. Warner, supra, at p. 830.)

In the absence of a statute authorizing class arbitration or agreement of the parties, it is inappropriate in my view for us, judicially, to superimpose such a procedure on the arbitration process over objections of a party to the contract. (Compare, Stevenson v. Com., Dept. of Revenue (Pa. 1980) 413 A.2d 667 [the Pennsylvania Board of Arbitration of Claims Act specifically incorporates procedures embodied in rules of Pennsylvania civil procedure and class action is therefore available to parties appearing before board].)

The majority is compelled to acknowledge that class-wide arbitration "would entail a greater degree of judicial involvement than is normally associated with arbitration . . . ." (*Ante*, p. 28a-29a.) Nonetheless, it argues that if the alternative would be to require hundreds of individual arbitration proceedings, then such a procedure may be appropriate. I believe, however, that the majority fails to accord proper deference to the recognized principle that arbitration is a *favored* means of dispute resolution because it permits a *non-judicial, informal,* and *speedy* alternative to litigation. (See, e.g., Taylor v. Crane (1979) 24 Cal.3d 442, 452; Doers v. Golden Gate Bridge etc. Dist. (1979) 23 Cal.3d 180, 189; Aerojet-General Corp. v. American Arbitration Assn. (9th Cir. 1973) 478 F.2d 248, 251.) The injection of class action procedure into the arbitration process *in the absence of either statutory authority or contractual agreement* conflicts with these settled principles as well as with the specific contract terms to which the parties agreed. "It is axiomatic that commercial arbitration is to be based on a voluntary agreement of the parties[;] only then can the concept of arbitration be well understood. In other words, nobody should be bound to resort to arbitration unless he has previously agreed to that method of dispute settlement." (Domke on Commercial Arbitration (1968) § 1.02, p. 5.)

The franchisees here do not contend that they would be unable to proceed individually in separate or consolidated arbitration proceedings. We are not confronted with a situation in which a plaintiff contends that it would be economically unfeasible to mount a challenge in the absence of a class

proceeding. In fact, not all of the actions before us have been brought as class actions. It is very clear that the individual franchisees have been fully able to proceed.

In a case where class proceedings provide the only economical method of presenting a claim, an alternative exists which would protect both the contractual integrity of proper arbitration agreements and the interests of individual claimants. One solution which has been suggested, and which the majority rejects, "would be to hold that arbitration agreements contained in contracts of adhesion may not operate to stay properly maintainable class actions." (*Ante*, p. 25a.) I agree that as a general rule such a holding would be contrary to the basic arbitration agreement of the parties and to the policy favoring arbitration. There is, however, another alternative. Under settled principles of law, arbitration clauses in adhesion contracts may be declared invalid where they are "beyond the reasonable expectations of an ordinary person . . ." (Wheeler v. St. Joseph Hospital (1976) 63 Cal.App.3d 345, 357) or bear oppressively on the weaker party. (Madden v. Kaiser Foundation Hospitals (1976) 17 Cal.3d 699, 710; Graham v. Scissor-Tail, Inc. (1981) 28 Cal.3d 807, 820.) Thus, where an arbitration clause in an adhesion contract would allow the stronger party to evade responsibility for its acts, such a clause may, under those facts, be found oppressive and the clause invalidated. In instances where an arbitration clause would effectively deny relief to the weaker party in an adhesion contract, relief under settled principles of law would potentially be available. As the majority concludes, there is no such evasion of liability here, and consequently, there is no need for an extraordinary remedy such as the one proposed by the majority.

In summary, the majority, in the absence of any contractual, statutory, or judicial authority or any demonstrated need, has seen fit to invent a procedure which is fundamentally contrary to the purpose of arbitration and to the public policy encouraging arbitration. Potentially, the majority's holding will effectively render arbitration clauses in all adhesion contracts subject to class treatment, thus engrafting on an informal,

speedy method of dispute resolution which often utilizes non-legal arbitrators a complex legal procedure which will require close court supervision and frequent intervention antithetical to the essential informal and nonjudicial nature of the arbitration process.

CONCLUSION

From the foregoing, I conclude that the trial court erred in holding that the Franchise Investment Law claims were not arbitrable in the face of the clear national substantive law to the contrary. I would reverse the trial court judgment to the extent that it denies arbitration of these claims. In addition, I conclude that in the absence of any statutory or contractual agreement to the contrary, the strong policy reasons favoring arbitration as a speedy, informal, and nonjudicial method of dispute resolution militate against the remand of this case to the trial court to permit it to determine whether class arbitration may be an appropriate procedure. I would affirm the trial court's order referring the individual cases to arbitration, recognizing that *consolidation* of the individual arbitrations might be proper.

RICHARDSON, J.

I CONCUR:

MOSK, J.

APPENDIX B

Court of Appeal, First District, Division 3

Civ. 45162, Civ. 46123

Aug. 28, 1980

Rehearing Denied Sept. 26, 1980

RICHARD D. KEATING et al.,

Petitioners,

—v.—

SUPERIOR COURT, ALAMEDA COUNTY,

Respondent,

THE SOUTHLAND CORPORATION et al.,

Real Parties in Interest.

PAULINO GARZA et al.,

Plaintiffs and Respondents,

—v.—

THE SOUTHLAND CORPORATION et al.,

Defendants and Appellants.

[And 8 other cases.]*

* *Cheng v. The Southland Corporation; Newell v. The Southland Corporation; Sampson v. The Southland Corporation; Gouveia v. The Southland Corporation; Battersby v. The Southland Corporation; Keating v. The Southland Corporation; Coy v. The Southland Corporation; The Southland Corporation v. Scovis.*

FEINBERG, Associate Justice.

Pursuant to stipulation, we ordered these two cases consolidated because both concern the trial court's orders regarding the propriety of arbitration vis-a-vis franchisors and franchisees.

In *Keating, et al. v. Superior Court*, petitioners (franchisees), seek a writ of prohibition or mandate to set aside the trial court's order to arbitrate pursuant to a contractual arbitration provision. Petitioners claim that the trial court erred: (1) by ruling that the contracts containing the arbitration clauses were not contracts of adhesion and by denying petitioners an evidentiary hearing concerning the validity of the arbitration clauses before ordering arbitration; (2) by failing to find that real parties had waived the right to compel arbitration; and (3) by failing to decide certain class action issues before ordering arbitration so that any arbitration could be conducted on a class-wide basis.

In *Garza, et al. v. The Southland Corporation, et al.*, appellants (franchisors), claim that the trial court erred by failing to order arbitration of certain claims based upon the California Franchise Investment Law. They contend that, by their terms, the arbitration clauses require this result and that Corporations Code section 31512 does not invalidate contractual provisions calling for arbitration of claims arising under the Franchise Investment Law.

KEATING, ET AL. v. SUPERIOR COURT

Petitioners are current and former franchise operators of 7-Eleven Stores in the Bay Area. Real parties are The Southland Corporation (franchisors) and various current and former employees of the corporation. This petition arises from a group of cases which were coordinated under the title "Market Franchise Cases" (Judicial Council Coordination Proceeding No. 387).[1] Petitioners' complaints included claims

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1 The coordinated actions are:

Gouveia v. The Southland Corporation (Gouveia), filed September 1975;

of fraud, misrepresentation and breach of contract, in addition to allegations of violations of the Franchise Investment Law.

Real parties filed their first petition to compel arbitration on September 28, 1977 in the *Keating* case. Ultimately, similar petitions were filed in all of the cases, and those petitions were granted with respect to all matters except the Franchise Investment Law claims.

I. *The trial court did not err by denying petitioners an evidentiary hearing concerning the validity of the arbitration clauses before ordering arbitration.*

All of the franchise agreements contained arbitration provisions. Real parties assert that the clause contained in the Keating contract is identical to or representative of the provisions contained in the other contracts. That clause is reproduced in the margin.[2]

Garza v. The Southland Corporation (Garza), filed September 1976;

Sampson v. The Southland Corporation (Sampson), filed October 1976;

Cheng v. The Southland Corporation (Cheng), filed December 1976;

Newell v. The Southland Corporation (Newell), filed January 1977;

Keating v. The Southland Corporation (Keating), filed May 1977; and

Battersby v. The Southland Corporation (Battersby), filed December 1977.

Two other actions have been coordinated which are not the subject of this petition: *Coy v. The Southland Corporation*, filed March 1978, and *Scovis v. The Southland Corporation*, filed April 1978.

2 Article 35. Arbitration.

(a) Unless prohibited by applicable law, any controversy or claim arising out of or relating to this Agreement or the breach hereof shall be settled by arbitration in accordance with the Rules of the American Arbitration Association (the "Association") and judgment upon any award rendered by the arbitrator may be entered in any court having jurisdiction thereof.

(Footnote continued on following page)

In his declaration in opposition to real parties' petition to compel arbitration, Richard D. Keating stated that:

". . .

"2) Other than the information that is set forth in an American Arbitration Association pamphlet . . . and the

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(b) Any demand for arbitration shall contain a statement setting forth the nature of the dispute, the amount involved, if any, and the remedy sought.

(c) Any demand for arbitration which may be based in whole or in part on wrongful Termination shall be filed within ten days after a 30 day or longer notice of Termination is issued and prior to any other notice of Termination becoming effective.

(d) Any other demand for arbitration may be filed with the Association and served on the other party at any time during the term of this Agreement or within the period provided by the applicable statute of limitations.

(e) Arbitration shall not proceed until any protest of arbitrability is resolved by an appropriate court, if necessary.

(f) A demand for arbitration or proceedings in arbitration shall not operate to stay, postpone, prohibit or rescind any Expiration or Termination or the right of 7-ELEVEN to take possession of the Leased Property in accordance with this Agreement (unless otherwise provided by applicable law), and the parties will be relegated to their remedy in damages, as determined by the arbitrator, for Expiration or Termination found by the arbitrator to be wrongful.

(g) The arbitrator shall have authority to assess damages sustained by reason of any breach of this Agreement.

(h) The arbitrator shall not extend, modify or suspend any of the terms of this Agreement or the reasonable standards of business performance set by 7-ELEVEN in good faith.

(i) The decision of the arbitrator within the scope of the submission (as provided in this Article 35) shall be final and binding on all parties, and any right to judicial action on any matter subject to arbitration hereunder is hereby waived (unless otherwise provided by applicable law), except suit to enforce the arbitration award or in the event arbitration is not available for any reason other than for the time periods provided herein.

(j) The parties shall share equally all expenses of the arbitrator and the Association, and each party shall bear his own expenses incident to the arbitration.

(k) If the rules of the Association differ from this Article 35, the provisions herein shall control.

information that is set forth in the Southland Store Agreement within the arbitration paragraphs . . . and what was set forth on page SA-78 . . . , I was given no verbal or written explanation of the meaning of arbitration, the concept of an arbitration proceeding, the fact that it involved my waiver of my constitutional rights to a jury trial, a loss of the right to utilize the protection of the courts in the discovery process, nor any information with respect to what arbitration would cost in a procedure of this type;

"3) The Southland agreements were presented to me by Southland representatives on a take it or leave it basis. I was given no opportunity to bargain or to negotiate with respect to any paragraph or clause within the said agreements. I was advised in effect, that the only way I could obtain the 7-11 franchise was to acquiesce to the entire printed agreement that was presented to me by the Southland representatives.

"4) There was nothing presented to me in writing or verbally that bore on the subject of the scope or limits of the subject matter to which the arbitration paragraphs purportly [sic] apply;

"5) The first time that I was aware of any aspect of what the arbitration clause might conceivingly [sic] be interpreted as meaning and the effect that said clause would have on my right to a jury and discovery and the possible impact on me as to the cost of such arbitration, occurred after I first contacted my attorneys in this case."

The American Arbitration Association pamphlet to which the declaration refers includes a reproduction of a sample commercial arbitration clause and general information about the association and its services. The association's tribunals were described as follows: "Important arbitration tribunals of AAA are: Commercial, Accident Claims, Labor and International. Each tribunal is administered under Rules which govern conduct of parties, arbitrators and the administrative agency. Members of the Association and non-members are treated equally. Arbitrations conducted in this way result in awards

that are enforceable under law. The Association cooperates closely with lawyers and trade associations." The other information to which the Keating declaration refers is the following statement which appeared in very large print by itself under an even larger caption, "ARBITRATION."

> "SHOULD A DISPUTE ARISE BETWEEN YOU AND 7-ELEVEN, THE DISAGREEMENT WILL BE SETTLED BY THE AMERICAN ARBITRATION ASSOCIATION."

The trial court found that the contracts were not adhesion contracts, as a matter of law.

Petitioners contend that Keating's affidavit raised a triable issue of fact concerning the validity of the arbitration clauses which should have been resolved before arbitration was ordered. They argue that, not only did the affidavit establish that the clauses were part of adhesion contracts about which petitioners were unable to bargain or negotiate, but also that the affidavit demonstrated real parties' failure to inform petitioners that agreeing to arbitration would result in waiving their rights to jury trial, discovery and punitive damages as a remedy for fraud nor were they informed of the costs of arbitration in an "unusual" or "complex" case such as this one.

Initially, it should be noted that since the franchise agreements were between a Texas corporation and California residents, entailed the right to use federally registered trademarks, and contemplated a continuing business relationship between the parties across state lines, they involve interstate commerce and fall within the ambit of the Federal Arbitration Act.[3]

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3 Section 2 of the act provides that: "A written provision in . . . a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." (9 U.S.C., § 2.) "Commerce" is defined, in part, as "commerce among the several States." (9 U.S.C., § 1.)

However, we find it unnecessary to address the subject of preemption at this juncture because we have concluded that both federal and state law require us to reject petitioners' adhesion contract theory.

Since petitioners were neither consumers nor persons who would have had to accept the agreements at issue or forego necessary goods or services, the franchise agreements were not made in the setting in which the courts are most concerned with the doctrine of adhesion contracts. (*Madden v. Kaiser Foundation Hospitals* (1976) 17 Cal.3d 699, 711, 131 Cal.Rptr. 882, 552 P.2d 1178.) Petitioners were persons interested in establishing a beneficial business relationship with Southland Corporation, who, no doubt, could have gone elsewhere if they were dissatisfied with the proffered arrangement. Nevertheless, it cannot be said that the parties possessed absolute parity of bargaining power. Southland drafted the contracts, and Keating claimed that they were present [sic] on a "take it or leave it" basis, a fact which is relevant to the determination of whether a contract is one of adhesion. (*Id.*, at pp. 710-711, 131 Cal.Rptr. 882, 552 P.2d 1178; *Rust v. Drexel Firestone Inc.* (S.D.N.Y. 1972) 352 F.Supp. 715, 717.)

However, the critical question under both the federal and California standards does not appear to be whether an agreement is an adhesion contract but, rather, whether the arbitration clause itself is oppressive or defeats the reasonable expectations of the parties. (*Arkoosh v. Dean Witter & Co., Inc.* (D.Neb. 1976) 415 F.Supp. 535, 543; *Madden v. Kaiser Foundation Hospitals, supra,* 17 Cal.3d at pp. 710, 712, 131 Cal.Rptr. 882, 552 P.2d 1178.) There is no indication that the franchisees and the franchisors were not equally affected by the arbitration clause.

Despite the importance of the constitutional right to a jury trial in a civil case (U.S.Const., 7th Amend.; Cal. Const., art. I, § 16), the failure to include an express waiver of this right in an arbitration agreement does not render the agreement unenforceable. (*Madden v. Kaiser Hospitals, supra,* 17 Cal.3d at p. 714, 131 Cal.Rptr. 882, 552 P.2d 1178.) Given this proposition, a fortiori, such an express waiver was not required respecting

petitioners' rights to discovery and punitive damages nor were real parties required to give petitioners the aforementioned information regarding costs in order for the arbitration provision to be enforceable.

Petitioners rely upon *Main v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* (1977) 67 Cal.App.3d 19, 24, 136 Cal.Rptr. 378, 380, in which Justice Molinari stated that: "The [Federal] Arbitration Act provides for a 'trial,' by jury if requested, of the issue of whether a *valid* agreement to arbitrate the subject dispute is existent [citation]; the issue to be resolved does not concern 'the merits of the controversy as to which arbitration is sought.' [Citation.] The issue ' " 'should not be determined on affidavits, but rather a full trial should be had.' " ' (*A/S Custodia v. Lessin International, Inc.* (2d Cir. 1974) 503 F.2d 318, 320; *El Hoss Engineer. & Transport Co. v. American Ind. Oil Co.* (2d Cir. 1961) 289 F.2d 346, 351 [cert. den., 368 U.S. 837, [82 S.Ct. 51, 7 L.Ed.2d 38] . . .].)" However, the federal cases upon which Justice Molinari relied did not raise the issue presented here. Furthermore, *Main* is distinguishable from the instant case because petitioners have not alleged that real parties' conduct constituted fraud which permeated the entire agreement or induced the arbitration clause itself, as did the plaintiff in *Main*. (67 Cal.App.3d at pp. 27, 33, 136 Cal.Rptr. 378.)

Petitioners also rely upon *Wheeler v. St. Joseph Hospital* (1976) 63 Cal.App.3d 345, 361, 133 Cal.Rptr. 775, 786, in which the court concluded "that in order to be binding, an arbitration clause incorporated in a hospital's 'CONDITIONS OF ADMISSION' form should be called to patient's attention and he should be given a reasonable explanation of its meaning and effect, including an explanation of any options available to the patient." Not only is *Wheeler* distinguishable given the circumstances peculiar to the hospital admission situation (*id.*, at pp. 357-358, 133 Cal.Rptr. 775), Keating's affidavit showed that he was aware of the clause's existence, and demonstrated that he should have been aware what the clause meant, namely, if arbitration were sought, he would be compelled to forego his right to a judicial forum. In *Wheeler* the court wrote that "The

hospital's admission clerk need only direct the patient's attention to the arbitration provision, request him to read it, and give him a simple explanation of its purpose and effect, including the available options. Compliance will not require the presence of the hospital's house counsel in the admission office." (Id., at p. 361, 133 Cal.Rptr. at p. 786, fn. omitted.) Given the propriety of such a "simple explanation" in the medical services context, we do not believe that *Wheeler* supports the kind of explanation to which petitioners claim they were entitled.

The trial court did not err by refusing to conduct an evidentiary hearing concerning the validity of the arbitration clause under the principles of adhesion contracts before ordering arbitration.

II. *Real parties did not waive their contractual right to compel arbitration.*

In rejecting petitioners' waiver argument, the trial court reasoned that although it probably would have concluded that there had been a waiver of the right to compel arbitration in some of the cases, such a ruling was not appropriate because (1) the second amended complaint raised certain issues, exclusive of the Franchise Investment Law claims, which would otherwise be arbitrable and "it would serve no one's purpose to order that those newly added matters of the second amended complaint should be submitted to arbitration, and other matters not . . ." and (2) it would detract from the achievement of consistency in the coordinated cases. The trial court also added the following condition to its order: "To the extent that this order grants Southland's petitions for order to compel arbitration, said petitions are granted on the condition that Southland either abstain from the use of any discovery that it has had in any of the above actions, or that Southland stipulate to discovery of at least an equally extensive nature on behalf of the plaintiffs in these actions."

Once again, there is a question of whether this issue is governed by federal or state law. However, it appears that petitioners' contention fails in either case.

The right to seek arbitration may be waived (9 U.S.C. section 3; Code Civ. Proc. section 1281.2, subd. (a)). It appears that when a claim of waiver is based upon actions taken before a court, the federal rule directs that the issue be resolved by the court rather than by the arbitrator. (*Weight Watch. of Quebec Ltd. v. Weight W. Int., Inc.* (E.D.N.Y. 1975) 398 F.Supp. 1057, 1059.) The California rule also assigns this question to the courts. (Code Civ.Proc., section 1281.2, subd. (a); also see, *Butchers Union v. Farmers Markets* (1977) 67 Cal.App.3d 905, 913, 136 Cal.Rptr. 894.)

The federal courts have held that where a party asserts arbitration in its answer as an affirmative defense, there is a heavy burden on the party seeking to establish waiver. (*Martin Marietta Aluminum, Inc. v. General Elec. Co.* (9th Cir. 1978) 586 F.2d 143, 146; *Hilti, Inc. v. Oldach* (1st Cir. 1968) 392 F.2d 368, 371.) Furthermore, "[c]ourts have specifically held that this factor alone is sufficient to defeat a claim of waiver. [Citations.]" (*Michael v. SS Thanasis* (N.D. Cal. 1970) 311 F.Supp. 170, 181.) Real parties' answers included such assertions with the exception of the one which they filed in the *Gouveia* case.

While federal law requires the courts to consider several factors in determining whether there has been a waiver of the right to demand arbitration, including the dilatory conduct of the party seeking arbitration and any other actions taken by the moving party which are inconsistent with seeking arbitration, a crucial inquiry is whether the conduct cited in support of this claim has resulted in prejudice to the party asserting waiver. If the element of prejudice is absent, waiver usually will not be found. (*Shinto Shipping Co. v. Fibrex & Shipping Co., Inc.* (9th Cir. 1978) 572 F.2d 1328, 1330; *Erving v. Virginia Squires Basketball Club* (2d Cir. 1972) 468 F.2d 1064, 1068; *Weight Watch. of Quebec Ltd. v. Weight W. Int., Inc., supra,* 398 F.Supp. 1057, 1059.) While "[s]ufficient prejudice to infer waiver might be found, for example, if the party seeking the stay *took advantage* of judicial discovery procedures not available in arbitration. [Citations.]" (*Carcich v. Rederi A/B Nordie* (2d Cir. 1968) 389 F.2d 692, 696, fn. 7, emphasis added.),

the condition which the trial court included in its order compelling arbitration would appear to have disspelled any prejudice which might have resulted from any inequality in discovery.

Moreover, it is not clear that real parties' conduct can be characterized as dilatory. They moved to compel arbitration approximately four months after the complaint was filed in the *Keating* case and, apparently, filed similar petitions in the individual cases within a month of the filing of amended complaints.[4] Not only did those amended complaints raise complex bookkeeping and accounting issues, but, as the trial judge noted, they were otherwise arbitrable.

Petitioners note that in the *Gouveia, Newell, Sampson* and *Keating* cases real parties either cross-complained or counterclaimed before seeking arbitration, and argue that by "irrevocably . . . [locking] litigious horns . . . [citation]," (*Hilti, Inc. v. Oldach, supra,* 392 F.2d 368, 371) waived their right to demand arbitration. In *Gouveia,* real parties also filed a separate action for a receivership and, in *Keating,* they attempted to remove the case to federal court and filed an unlawful detainer action for default under the franchise contract before seeking arbitration. While such conduct would appear to be inconsistent with an intent to seek arbitration, it does not amount to prejudice. "As an abstract exercise in logic it may appear that it is inconsistent for a party to participate in a lawsuit for breach of contract, and later to ask the court to stay that litigation pending arbitration. Yet the law is clear that such participation, standing alone, does not constitute a waiver, [citations], for there is an overriding federal policy favoring arbitration." (*Carcich v. Rederi A/B Nordie, supra,* 389 F.2d at p. 696.)

Petitioners rely upon *Barber & Ross Company v. Cornell & Company* (D.D.C. 1965) 242 F.Supp. 825, aff'd in (D.C.Cir. 1966) 360 F.2d 512, in which the court declined to order arbitration where the party seeking arbitration had filed a

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4 When the trial court heard the petitions in the individual cases, the parties stipulated that a similar petition be deemed to have been made in the *Buttersby* class action.

motion for a change in venue, an answer, and a counterclaim, and had begun taking a deposition before it made its request for arbitration. However, we are persuaded that the inclusion of arbitration as an affirmative defense in all but one of real parties' answers, and trial court's equalization of any disparity in discovery, and the amendment to petitioners' pleadings distinguish this case from *Barber.*

As we noted above, California law also requires us to conclude that the trial court did not err in rejecting petitioners' claim of waiver. Since arbitration is a favored means of settling disputes, "the courts have been admonished to 'closely scrutinize any allegation of waiver of such favored right' [citation] and to 'indulge every intendment to give effect to such proceedings' [citations]." (*Doers v. Golden Gate Bridge Etc. Dist.* (1979) 23 Cal.3d 180, 189, 151 Cal.Rptr. 837, 842, 588 P.2d 1261, 1266.) Nevertheless, the right to compel arbitration may be waived. "[¶] Waiver of a contractual right to arbitration is ordinarily a question of fact and determination of this question, if supported by substantial evidence, is binding on an appellate court. [Citation.]" (*Id.*, at p. 185, 151 Cal.Rptr. at p. 839, 588 P.2d at p. 1263.)

Our Supreme Court has recently indicated that there is no single test for determining whether the right to demand arbitration has been waived. (*Davis v. Blue Cross of Northern California* (1979) 25 Cal.3d 418, 426, 158 Cal.Rptr. 828, 600 P.2d 1060.) "California courts have found a waiver of the right to demand arbitration in a variety of contexts, ranging from situations in which the party seeking to compel arbitration has previously taken steps inconsistent with an intent to invoke arbitration [citations] to instances in which the petitioning party has unreasonably delayed in undertaking the procedure. [Citations.] The decisions likewise hold that the 'bad faith' or 'wilful misconduct' of a party may constitute a waiver and thus justify a refusal to compel arbitration. [Citation.]" (*Id.*, at pp. 425-426, 158 Cal.Rptr. at p. 832, 600 P.2d at p. 1064.) While the "mere filing of a lawsuit does not constitute a waiver of the right to arbitrate", the "judicial *litigation* of the merits of arbitrable issues . . . waives a party's right to arbitration."

(*Doers v. Golden Gate Bridge Etc. Dist., supra,* 23 Cal.3d 180, 183, 188, 151 Cal.Rptr. 837, 841, 588 P.2d 1261, 1265.) A party who includes arbitration as an affirmative defense in his answer may be able to avoid a finding of waiver. (Cf. *Butchers Union v. Farmers Markets, supra,* 67 Cal.App.3d 905, 913, 136 Cal.Rptr. 894.) Finally, while the concept of prejudice is not as significant as it is in federal law, it is relevant to the question of waiver. (*Doers v. Golden Gate Bridge Etc. Dist., supra,* 23 Cal.3d 180, 188, 151 Cal.Rptr. 837, 588 P.2d 1261.) A consideration of the facts which lead us to conclude that there was no waiver under federal law also leads us to conclude that there was substantial evidence to support the trial court's finding of no waiver under California law.

The facts which distinguish this case from *Barber* also distinguish it from *Gunderson v. Superior Court* (1975) 46 Cal.App.3d 138, 120 Cal.Rptr. 35, disapproved in *Doers v. Golden Gate Bridge Etc. Dist., supra,* 23 Cal.3d 180, 188, 151 Cal.Rptr. 837, 588 P.2d 1261. Similarly, we have concluded that petitioners' reliance upon *McConnell v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* (1980) 105 Cal.App.3d 946, 164 Cal.Rptr. 751 is misplaced. In addition to the factual discrepancies alluded to in the discussion of *Barber* and *Gunderson,* there were no pretrial proceedings in this case which could be analogized to the five "lengthy" hearings regarding class certification which were conducted in *McConnell* before arbitration was sought.

In light of our discussion, we find it unnecessary to address petitioners' argument that the trial court abused its discretion by relying upon the fact that the various cases had been coordinated in ordering arbitration.

III. *The trial court should have determined the class actions issues.*

In the *Keating* and *Battersby* cases, the named plaintiffs seek to represent some 800 persons who are California 7-Eleven franchisees who have entered into identical agreements with Southland Corporation during a four-year period. Petitioners contend that if arbitration is appropriate, the trial court should

be instructed to determine the preliminary issues regarding class certification before the cases are resolved on their merits. The issue presented appears to be one of first impression.

Our review of the record indicates that while petitioners argued this point in the context of real parties' petitions to compel arbitration, no motion to certify the class was made, and the trial court did not expressly rule on the matter. In *Phelan v. Superior Court* (1950) 35 Cal.2d 363, 372, 217 P.2d 951, 956 the Supreme Court wrote that "Before seeking mandate in an appellate court to compel action by a trial court, a party should first request the lower court to act. If such request has not been made the writ ordinarily will not issue unless it appears that the demand would have been futile. [Citations.]" However, while petitioners did not focus upon this issue by means of a specific motion, the question clearly was raised before the trial court. Furthermore, given that petitioners argued that arbitration should not be ordered until the preliminary class action questions were determined, the trial judge implicitly rejected petitioners' argument by ordering arbitration. Thus, making a more formal demand would have been futile.

It appears that no federal decision had dealt with this question; however, there is some authority which indicates that the class action and arbitration procedures could be joined in an appropriate case. Under Federal Rule of Civil Procedure 81(a)(3) which provides that the federal rules apply to proceedings under the Federal Arbitration Act to the extent that the act does not provide for procedural matters, the courts have held that consolidation of arbitrations is permissible pursuant to Federal Rule of Civil Procedure 42. (*Compania Espanola de Pet., S.A. v. Nereus Ship.* (2d Cir. 1975) 527 F.2d 966, 975, cert. den. 426 U.S. 936, 96 S.Ct. 2650, 49 L.Ed.2d 387; *Marine Trading Ltd. v. Ore Intern. Corp.* (S.D.N.Y. 1977) 432 F.Supp. 683, 684; *Robinson v. Warner* (D.R.I. 1974) 370 F.Supp. 828, 829-830.) Applying rule 23 of the Federal Rules of Civil Procedure to arbitration proceedings would appear to be a logical extension of the theory employed in the consolidation cases.

Real parties respond that Rule 81(a)(3) only applies to *judicial* proceedings, and, therefore, cannot serve as a means for applying rule 23 to arbitrations. (*Great Scott Supermkts., Inc. v. Local U. No. 337, Teamsters* (E.D. Mich., S.D. 1973) 363 F.Supp. 1351, 1354.) However, given the fact that issues such as those involved in the certification of the class would be dealt with by the court before the matter was sent to the arbitrator, petitioners appear to be correct in arguing that real parties' claim misses the mark. (Cf. *Robinson v. Warner, supra,* 370 F.Supp. 828, 830.)

Real parties also argue that imposing the class action format upon arbitrations would result in unnecessary interference by the courts in and undue delay of the arbitration process. The most forceful claim made in this regard concerns the requirement that the courts oversee the adequacy of representation by the named plaintiffs of the interests of absent class members. (*In re General Motors Corp. Engine Interchange Lit.* (7th Cir. 1979) 594 F.2d 1106, 1124, cert. den. 444 U.S. 870, 100 S.Ct. 146, 62 L.Ed.2d 95; *Guerine v. J. & W. Inv., Inc.* (5th Cir. 1977) 544 F.2d 863, 864; *Gonzales v. Cassidy* (5th Cir. 1973) 474 F.2d 67, 75.) In this connection, real parties also note that court approval must be obtained in order to dismiss or settle a class action. (Fed.R.Civ.P. 23(e).)

Turning to California law, the two California decisions which have considered the relationship between arbitration and the class action procedure do not appear to be dispositive. In *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* (1971) 20 Cal.App.3d 668, 672, 97 Cal.Rptr. 811, 818 the court rejected respondent's argument that arbitration should not be required because respondent had brought his action on behalf of the class of persons affected by the contract at issue. "But if all employees similarly situated have signed the same arbitration agreement as that which respondent challenges, all are equally bound. If the agreement is valid, it is valid as to all members of the class. It would be inappropriate to allow respondent and the other members of the class he claims to represent to evade the terms of the agreement simply by bringing their action together as a 'class' rather than as individuals."

In *Vernon v. Drexel Burnham & Co.* (1975) 52 Cal.App.3d 706, 125 Cal.Rptr. 147, the court reversed the trial court's denial of the defendant's petition to compel arbitration. The court concluded that the trial court had relied upon a faulty premise and held that "if VERNON did proceed alone to arbitration it would not mechanically render him unfit to represent a class or subclass of customers of DREXEL BURNHAM similarly situated. The determination whether or not VERNON can fairly and adequately protect that class rests in the sound discretion of the trial court [citation], although, of course, VERNON may be disqualified to act as a representative plaintiff to subclasses of customers of DREXEL BURNHAM, if any, where the arbitration clause is not a factor. [Citation.]" (52 Cal.App.3d at p. 715, fn. 4, 125 Cal.Rptr. at p. 152.) The court also held that "in the instant case, the policy of law favoring arbitration prevails over the policy of the law pertaining to class actions . . . ." (*Id.*, at p. 715, 125 Cal.Rptr. at p. 152.) The court reasoned that: (1) "arbitration is a recognized and favored means by which parties expeditiously and efficiently may settle disputes which might otherwise take years to resolve. [Citations.]"; (2) "[¶] . . . there is perhaps no higher public policy than to uphold and give effect to contracts validly entered into and legally permissible in subject matter . . . ."; and (3) "[¶] . . . the substantive law of contractual agreement takes precedence over the class action, which is merely a procedural device for consolidating matters properly before the court." (*Id.*, at pp. 715-716, 125 Cal.Rptr. at p. 153.)

Real parties argue that *Vernon* is controlling because, given the procedural context in which it was decided, the court rejected the very order which petitioners seek here—a postponement of the determination of the arbitration petition pending certification of the class. However, not only is it unclear that the trial court's order in *Vernon* amounted to a postponement of the determination of the arbitration petition pending *certification* of the class because such certification would require the resolution of other issues such as the adequacy of named representatives, but *Vernon* also appears to be

factually distinguishable in at least two important respects. First, as petitioners note, it was not clear that the case involved class-wide issues regarding arbitration because "neither VERNON nor DREXEL BURNHAM . . . [had] alleged or proved that the other purported members of the class represented by VERNON entered into or were subject to the same or similar agreements; . . ." (*Id.* at p. 711, 125 Cal.Rptr. at p. 150.) More importantly, it appears that the plaintiff in *Vernon* effectively argued that the existence of the class action vitiated his agreement to arbitrate, and the court specifically concluded that the trial court's order denying arbitration was based upon the incorrect premise discussed above. It should be noted that given this conclusion, the court's "holding" regarding what it perceived to be conflicting policy considerations was dicta.

Petitioners contend that since Code of Civil Procedure section 382 is silent on the question of class-wide arbitration, we should look to rule 23 of the Federal Rules of Civil Procedure for guidance. (*La Sala v. American Sav. & Loan Assn.* (1971) 5 Cal.3d 864, 872, 97 Cal.Rptr. 849, 489 P.2d 1113.) Real parties respond that the policy considerations discussed above concerning unnecessary judicial interference in and undue delay of arbitrations apply with equal force to California law. (*Sapp v. Barenfeld* (1949) 34 Cal.2d 515, 520, 212 P.2d 233; *East San Bernardino County Water Dist. v. City of San Bernardino* (1973) 33 Cal.App.3d 942, 949-950, 109 Cal.Rptr. 510; *McRae v. Superior Court* (1963) 221 Cal. App.2d 166, 171, 34 Cal.Rptr. 346.) They also argue that while consolidation is permissible in California, it cannot be equated with class-wide arbitration because the former procedure is of a limited nature and all parties are present. Real parties further note that in California Rule of Court 1600.5, subdivision (b), the Judicial Council exempted class actions from compulsory judicial arbitration, and argue that this action indicated that the Council was of the opinion that class actions were not amenable to arbitration.

We have concluded that there is no insurmountable obstacle to conducting an arbitration on a class-wide basis. In an

appropriate case, such a procedure undoubtedly would be the fairest and most efficient way of resolving the parties' dispute. The initial determinations regarding certification and notice will not unduly burden the arbitration because those matters must be resolved by the trial court before arbitration begins.

We wish to stress that we have formed no opinion upon the question of whether this case should proceed as a class action. However, if the trial court answers this question affirmatively, it will be necessary to devise methods to safeguard the rights of absent class members to adequate representation and in the event of dismissal or settlement. Since these matters may be purely academic and have not been thoroughly explored by the parties here, we shall leave their determination to the trial court.

Let the peremptory writ of mandate issue directing the trial court to determine the preliminary class action issues, including the suitability of the action as a class suit, the composition of the class, and the appropriate notice procedure, in accordance with the guidelines established in Federal Rule of Civil Procedure 23. Insofar as the petition seeks a writ to compel the trial court to set aside its order compelling arbitration, it is denied.

Each side is to bear its own costs for proceedings on the writ petition.

GARZA, ET AL. v. THE SOUTHLAND CORPORATION, ET AL.

The Southland Corporation and various employees and former employees have appealed from the trial court's denial of their petitions to compel arbitration concerning certain claims made against them pursuant to the Franchise Investment Law. (Corp. Code, § 31000 et seq.)

The claims which respondents cite as being typical of those at issue here relate to appellants' failure to disclose information at least 48 hours prior to the execution of the franchise agreements and certain wilful misrepresentations and omissions in the disclosure statements which appellants did make. The parties agree that although the trial judge relied primarily

upon his interpretation of the contractual arbitration provisions as being too narrow to include respondents' claims, he also believed that the Legislature did not intend that claims pursuant to the Franchise Investment Law should be subject to arbitration.

1. *The arbitration clauses, by their terms, require arbitration of these claims.*

The arbitration clauses state, in pertinent part: "*any controversy or claim arising out of or relating to* this Agreement or the breach hereof shall be settled by arbitration in accordance with the Rules of the American Arbitration Association . . . ." (Emphasis added.) Looking to the language of the clauses as a principal source from which to derive the contracting parties' intent (*Healy Tibbets Construction Co. v. Employers' Surplus Lines Ins. Co.* (1977) 72 Cal.App.3d 741, 748, 140 Cal.Rptr. 375; Cal.Civ.Code, § 1638), the language emphasized above is broad enough to cover respondents' claims under the Franchise Investment Law.

Respondents' arguments to the contrary are untenable. Not only would it be unreasonable to require that an arbitration clause specify the legal basis for a claim in order for the clause to apply (*Weinrott v. Carp* (1973) 32 N.Y.2d 190, 344 N.Y.S.2d 848, 853-854, 298 N.E.2d 42), but it would also be unreasonable to assume that the violations at issue did not "arise out of" or "relate to" the franchise agreements, especially in light of the expressed legislative intent of the Franchise Investment Law.[5]

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5 Corporations Code section 31001 provides in pertinent part:

> It is the intent of this law to provide each prospective franchisee with the information necessary to make an intelligent decision regarding franchises being offered. Further, it is the intent of this law to prohibit the sale of franchises where such sale would lead to fraud or a likelihood that the franchisor's promises would not be fulfilled, and to protect the franchisor by providing a better understanding of the relationship between the franchisor and franchisee with regard to their business relationship.

Appellants rely upon various cases in which the courts have held that arbitration clauses which were similar to the ones at issue were broad enough to encompass tort as well as contract claims. (*Berman v. Dean Witter & Co., Inc.* (1975) 44 Cal.App.3d 999, 1003, 119 Cal.Rptr. 130; *Lewsadder v. Mitchum, Jones & Templeton, Inc.* (1973) 36 Cal.App.3d 255, 259, 111 Cal.Rptr. 405; *Acevedo Maldonado v. PPG Industries, Inc.* (1st Cir. 1975) 514 F.2d 614, 616.) While respondents may be correct in asserting that the torts at issue in these cases had occurred after the execution of the contracts, their attempt to distinguish this case is artificial. Although the "roots" of respondents' claims may be in the Franchise Investment Law, in a technical sense, their source is the creation of the franchise relationship. Furthermore, as appellants note, the United States Supreme Court has held that an arbitration clause such as the one at issue may extend to a claim that the creation of the contract was induced by fraud. (*Prima Paint Corp. v. Flood & Conklin Mfg. Co.* (1967) 388 U.S. 395, 403-404, 87 S.Ct. 1801, 1805-1806, 18 L.Ed.2d 1270.)

II. *Corporations Code section 31512 does not operate to invalidate contractual provisions insofar as they require that claims under the Franchise Investment Law be submitted to arbitration, and, even if it did, the statute would be superseded by federal law.*

Appellants contend that the Legislature did not intend Corporations Code section 31512 to be interpreted according to the doctrine established by the Supreme Court in *Wilko v. Swan* (1953) 346 U.S. 427, 74 S.Ct. 182, 98 L.Ed. 168.[6] They claim that the statute was designed to invalidate contractual provisions purporting to require that a franchisee surrender a right under the Franchise Investment Law and that the arbitration clause at issue does not come within that proscription.

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6 Corporations Code section 31512 provides:

> Any condition, stipulation or provision purporting to bind any person acquiring any franchise to waive compliance with any provision of this law or any rule or order hereunder is void.

"In proceeding with the task of interpretation . . . we are aided by certain general principles of statutory construction. As stated by this court in *Moyer v. Workmen's Comp. Appeals Bd.* (1973) 10 Cal.3d 222 . . ., at page 230 [110 Cal.Rptr. 144, 514 P.2d 1224]: 'We begin with the fundamental rule that a court "should ascertain the intent of the Legislature so as to effectuate the purpose of the law." [Citation.] In determining such intent "[t]he court turns first to the words themselves for the answer." [Citation.] We are required to give effect to statutes "according to the usual, ordinary import of the language employed in framing them." [Citations.]' " (*Palos Verdes Faculty Assn. v. Palos Verdes Peninsula Unified Sch. Dist.* (1978) 21 Cal.3d 650, 658-659, 147 Cal.Rptr. 359, 363, 580 P.2d 1155, 1159.) Applying these principles to section 31512, we agree that the Legislature does not appear to have intended that the section preclude arbitration of all claims brought under the Franchise Investment Law.

However, as appellants concede, to the extent that the statutory language can be argued to be ambiguous, another rule of statutory construction is relevant. That rule has been expressed by our Supreme Court as follows: "This court has long recognized the principle of statutory construction that '[w]hen legislation has been judicially construed and a subsequent statute on the same or an analogous subject is framed in the identical language, it will ordinarily be presumed that the Legislature intended that the language as used in the later enactment would be given a like interpretation. This rule is applicable to state statutes which are patterned after federal statutes. [Citations.]' [Citations.]" (*Belridge Farms v. Agricultural Labor Relations Bd.* (1978) 21 Cal.3d 551, 557, 147 Cal.Rptr. 165, 169, 580 P.2d 665, 669.)

In *Wilko v. Swan, supra,* 346 U.S. 427, 74 S.Ct. 182, 98 L.Ed. 168, the arbitration agreement at issue was subject to the provisions of the Federal Arbitration Act. The court concluded that "The words of § 14 . . . void any 'Stipulation' waiving compliance with any 'provision' of the Securities Act [of 1933]. This arrangement to arbitrate is a 'stipulation,' and we think the right to select the judicial forum is the kind of

'provision' that cannot be waived under § 14 of the Securities Act."[7] (346 U.S. at pp. 434-435, 74 S.Ct. at p. 186.)

Although the language of the two statutes is parallel and the statutory schemes containing them may have shared similar policy concerns, respondents have cited no authority which indicates that section 31512 was patterned after section 14. Moreover, unlike *Wilko,* which involved competing federal statutes, this case presents a conflict between a federal statute and a state statute. (*Allison v. Medicab Intern., Inc.* (1979), 92 Wash.2d 199, 597 P.2d 380, 382.)

Appellants argue that if section 31512 were interpreted according to the doctrine of *Wilko v. Swan,* the statute would conflict with the Federal Arbitration Act and would be void pursuant to the Supremacy Clause. (U.S.Const., Art. III, § 2.) We agree. If the doctrine were applied, section 31512 would conflict with the language in section 2 of the Federal Arbitration Act which makes provisions to arbitrate in contracts pertaining to transactions in interstate commerce "valid, irrevocable, and enforceable." Furthermore, the application of the rule in *Wilko v. Swan* does not fit within the exception in section 2 for "such grounds as exist at law or in equity for the revocation of any contract" because that exception appears to be directed toward tenets of general contract law.

In *Allison v. Medicab Intern., Inc., supra,* 597 P.2d 380, plaintiffs and defendants had entered into a franchise agreement for the transportation of the physically handicapped which contained an arbitration clause. Plaintiffs brought an action which included alleged violations of Washington's Franchise Investment Protection Act. Defendants' demand for arbitration was denied. On appeal, plaintiffs contended that "because the statute gives jurisdiction of such matters to state courts (RCW 19.100.-160), the arbitration clause does not

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7 Section 14 of the Securities Act provides:

"Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void." (15 U.S.C., § 77n.)

apply." (*Id.*, at p. 381.) The Supreme Court of Washington reversed. Having concluded the Federal Arbitration Act was controlling, the court said "[t]he majority rule . . . appears to be that the act does apply and requires a state court to enforce an arbitration clause despite a contrary state law or policy. [Citations.]" (*Id.*, at p. 382.) Applying this rule, the court rejected the claim that defendants' failure to register pursuant to the Franchise Investment Protection Act vitiated the arbitration clause. While the court did not specifically refer to the anti-waiver provision in the Franchise Investment Protection Act (RCW 19.100.220), the court distinguished *Wilko v. Swan* as follows: ". . . this case involved two federal acts and not as here the federal arbitration act and a state franchising act. [Citation.]" (*Id.*, at p. 382.)

In the recent case of *Barron v. Tastee Freeze Intern., Inc.*, (E.D.Wis. 1980) 482 F.Supp. 1213, the court denied the plaintiffs' motion to permanently enjoin a pending arbitration. Plaintiffs' claims included violations of the Wisconsin and Illinois franchise investment acts. In rejecting an argument analogous to the one which respondents make here, the court said that "Except in a few areas of law, however, notably the Federal Securities Act of 1933 and the federal antitrust statutes [citations], federal policy strongly favors the enforcement of arbitration clauses under Title 9 U.S.C." (*Id.*, at p. 1216; see *Romnes v. Bache & Co., Incorporated* (W.D.Wis. 1977) 439 F.Supp. 833.) The court concluded that: ". . . the effect of my holding with respect to this argument of the plaintiffs is to render void any effort made by a state to protect the remedies of franchise investors whose arguments encompass transactions in interstate commerce, even when the contracting parties are both residents of the state which passes the protective laws, see *Allison v. Medicab International, Inc.* 92 Wash.2d 199, 597 P.2d 380, 383 (1979), but that result is compelled by the language of 9 U.S.C. § 2 and by the authority of Congress under the Interstate Commerce and Supremacy Clauses of the United States Constitution to regulate interstate commercial transactions in the manner it sees fit and to

preempt state regulatory efforts which conflict with the federal scheme. (482 F.Supp. at p. 1217.)

Respondents' reliance upon *American Airlines, Inc. v. Louisville & Jefferson C.A.B.* (6th Cir. 1959) 269 F.2d 811 is misplaced. Not only did the court take a restrictive view of the scope of the Federal Arbitration Act (id., at pp. 816-817), but the argument made against enforcing the contract concerning the capacity of one of the parties appears to fit within the exception in section 2 of the Federal Arbitration Act for "such grounds as exist at law or in equity for the revocation of any contract."

The judgment is reversed and the trial court is directed to enter its order granting arbitration. Appellants are to receive costs on this appeal.

WHITE, P. J., and SCOTT, J., concur.

APPENDIX C

IN THE SUPERIOR COURT OF THE
STATE OF CALIFORNIA

IN AND FOR THE COUNTY OF ALAMEDA

JUDICIAL COUNCIL COORDINATION PROCEEDING NO. 387

Napa Superior Court No. 37402

COORDINATION PROCEEDING SPECIAL TITLE (Rule 1550(b))

MARKET FRANCHISE CASES

Included action:

Keating v. Southland

ORDER RE PETITION FOR ORDER TO ARBITRATE
[Filed February 16, 1978]

The Petition of defendant The Southland Corporation for Order to Arbitrate filed in the action entitled "Richard D. Keating, et al. vs. The Southland Corporation, et al., Napa County Superior Court, No. 37402," having come on for hearing the 30th day of January, 1978, before the Honorable Robert H. Kroninger, Judge of the Superior Court and Coordination Trial Judge, with Mark J. Spooner, Esq., of Arnold & Porter, and Charles G. Miller, Esq., of McKenna & Fitting, appearing on behalf of defendant The Southland Corporation, and John F. Wells, Esq., of Stark, Stewart, Simon & Sparrowe, Robert M. Brown, Esq., and John F. Banker, Esq., appearing on behalf of plaintiffs and respondents Richard D. Keating and Darla J. Keating, and the Court having considered the argument of counsel and all of the papers, memoranda, and briefs filed by the parties, and good cause appearing therefor;

IT IS HEREBY ORDERED that the Petition for Order to Arbitrate, originally filed on September 28, 1977, be, and the same hereby is, GRANTED, with the exception of the subject matter embracing line 19, page 5, through and including the sentence ending on line 1, page 6 of said petition.

IT IS HEREBY FURTHER ORDERED that further proceedings herein as to the *Keating* v. *Southland* action referred to above be, and the same hereby are, STAYED pending the outcome of such arbitration or until further order of this Court.

Presented and signed in open court this 16 day of February, 1978.

/S/ ROBERT H. KRONINGER
Judge of the Superior Court

APPENDIX D

IN THE SUPERIOR COURT OF THE
STATE OF CALIFORNIA

IN AND FOR THE COUNTY OF ALAMEDA

Judicial Council Coordination Proceeding No. 387

Napa Superior Court No. 37276

Santa Clara Superior Court No. 390132

Alameda Superior Court No. 469216-2, No. 505160-5, No. 505161-4, No. 505159-9, No. 505162-3, No. 505164-1

Added-On Cases

Alameda Superior Court No. 501580, No. 473115

Coordination Proceeding Special Title (Rule 1550(b))

MARKET FRANCHISE CASES

ORDER RE MOTIONS HEARD ON APRIL 26, 1978
[Filed May 5, 1978]

On April 26, 1978, the Petitions of Defendant The Southland Corporation for Order to Arbitrate Disputes and Motion for Stay of Proceedings Pending Arbitration in *Gouveia* v. *Southland* (No. 469216-2), *Garza* v. *Southland* (No. 505160-5), *Sampson* v. *Southland* (No. 505161-4) *Cheng* v. *Southland* (No. 505162-3) and *Newell* v. *Southland* (No. 505164-1) came on for hearing before the Honorable Robert H. Kroninger, Judge of the Superior Court and Coordination Trial Judge. The parties have stipulated that the same Petition and Motion shall be deemed to have been made in *Battersby* v. *The Southland Corporation* (No. 390132) and the Court may rule thereon at this time. Mark J. Spooner, Esq. of Arnold & Porter, and Charles G. Miller, Esq. and Martin H. Kresse, Esq. of McKenna & Fitting appeared on behalf of petitioner and

defendant The Southland Corporation, and John F. Wells, Esq. of Stark, Stewart, Simon & Sparrowe, Linda R. Joseph, of the Law Offices of Robert M. Brown, and John F. Banker, Esq. of Banker & Linderman, appeared on behalf of the plaintiffs and respondents in those actions.

The court having considered the arguments of counsel and all the papers, memoranda and briefs filed by the parties, and good cause appearing therefor,

IT IS HEREBY ORDERED that the petitions for order to arbitrate and motion for stay of proceedings in the above referenced cases be, and the same hereby are, GRANTED, with the exception of the claims based upon the California Franchise Investment Law, which claims are contained in the First Cause of Action of the Second Amended Complaints in the *Garza* and *Sampson* cases, and the First Cause of Action in the First Amended Complaint in the *Gouveia, Cheng* and *Newell* cases and the Second Cause of Action of the Complaint in the *Battersby* case. To the extent that this order grants Southland's petitions for order to compel arbitration, said petitions are granted on the condition that Southland either abstain from the use of any discovery that it has had in any of the above actions, or that Southland stipulate to discovery of at least an equally extensive nature on behalf of the plaintiffs in those actions.

IT IS HEREBY FURTHER ORDERED that further proceedings in the *Gouveia, Garza, Sampson, Cheng, Newell,* and *Battersby* cases, referred to above, be, and the same hereby are, stayed pending the outcome of such arbitration or until further order of this Court.

The plaintiffs in *Keating* v. *Southland* (No. 505159-9) have moved to lift the stay previously issued in that case for purposes of discovery; Southland has filed a notice of appeal from this Court's order denying its petition to compel arbitration of the Franchise Investment Law claims in *Keating* v. *Southland*; the parties have agreed that because of the appeal this Court probably lacks jurisdiction to rule on said motion, and said motion was withdrawn.

Plaintiffs in *Garza* v. *Southland* (No. 505160-5) have also moved for an order to set a discovery schedule and trial date in that case. The court having considered said motion, and having made its rulings with respect to arbitration above, IT IS HEREBY ORDERED that said motion be, and the same hereby is DENIED.

The Southland Corporation has filed a demurrer to answer, or, in the alternative, a motion to strike affirmative defenses in *Southland* v. *Battersby* (No. 501580-5). The Court having considered the matter, and the arguments of counsel, and good cause appearing therefor,

IT IS HEREBY ORDERED that the demurrer be, and the same hereby is, SUSTAINED, and the motion to strike be, and the same hereby is, GRANTED, as to the following portions of the Answer to First Amended Complaint: 1) page 2, line 15 through and including page 3, line 18, save and except for the last sentence in paragraph 5 at page 3 thereof; and 2) the First Affirmative defense. In all other respects the demurrer is overruled.

Defendant The Southland Corporation and certain other defendants have also filed demurrers to the Second Amended Complaints in the *Garza* and *Sampson* cases and to the First Amended Complaints in the *Gouveia, Cheng* and *Newell* cases. The court having considered these matters, and the arguments of counsel, and good cause appearing,

IT IS HEREBY ORDERED that the demurrers be, and the same hereby are, OVERRULED, and Southland and the demurring individual defendants shall have up to and including 30 days from the date of this Order in which to file answers to the complaints which were the subject of the demurrers, notice of said ruling having been waived.

Signed this 5th day of May, 1978, in open court.

/S/ ROBERT H. KRONINGER
Judge of the Superior Court and
Coordination Trial Judge

APPENDIX E

IN THE SUPERIOR COURT OF
THE STATE OF CALIFORNIA

IN AND FOR THE COUNTY OF ALAMEDA

Judicial Council Coordination Proceeding No. 387

Napa Superior Court No. 37402 now Alameda Superior Court No. 505159-9, No. 37276 now Alameda Superior Court No. 507470-3

Santa Clara Superior Court No. 35613 now Alameda Superior Court No. 505160-5, No. 361187 now Alameda Superior Court No. 505161-4, No. 364650 now Alameda Superior Court No. 505162-3, No. 366559 now Alameda Superior Court No. 505164-1, No. 390132

Alameda Superior Court No. 469216-2, No. 473115-3, No. 501580-5, No. 506120-6

Los Angeles Superior Court No. C 234510, No. C 235779

Coordination Proceeding Special Title (Rule 1550(b))

MARKET FRANCHISE CASES

Relating to: *Garza v. Southland*, Alameda Superior Ct. No. 505160-5; *Cheng v. Southland*, Alameda Superior Ct. No. 505162-3; *Newell v. Southland*, Alameda Superior Ct. No. 505164-1; *Sampson v. Southland*, Alameda Superior Ct. No. 505161-4; *Gouveia v. Southland*, Alameda Superior Ct. No. 469216-2; *Keating v. Southland*, Alameda Superior Ct. No. 505159-9; *Coy v. Southland*, Alameda Superior Ct. No. 506120-6; *Battersby v. Southland*, Santa Clara Superior Ct. No. 390132; *Southland v. Scovis*, Los Angeles Superior Ct. No. C-235779

ORDER RE MOTIONS HEARD ON JULY 19, 1978
[Filed July 31, 1978]

On July 19, 1978, various motions came on for hearing before this honorable Court in the above captioned coordinated actions. Mark J. Spooner, Esq., of Arnold & Porter, and Charles G. Miller, Esq., of McKenna & Fitting appeared on behalf of The Southland Corporation and the individual defendants and John F. Wells, Esq. and D. Barratt Irwin, Attorney at Law, of Stark, Stewart, Simon & Sparrowe, and Linda R. Joseph, of the Law Offices of Robert M. Brown, appeared on behalf of plaintiffs (except in the *Scovis* case, where they appeared for cross-complainants).

1. Petitions for Orders to Arbitrate and Motions for Stay of Proceedings Pending Arbitration were filed by the persons listed below in the below captioned coordinated actions:

Gouveia v. Southland (Second Amended Complaint), No. 469216-2 Ernest Arzabal, Michael Drury and Ray Berry

Garza v. Southland (Second Amended Complaint), No. 505160-5 Gene Janssen, Michael Wildman, Ray Berry and Robert Johnson

Sampson v. Southland (Second Amended Complaint), No. 505161-4 Ray Berry and Dave Pava

Newell v. Southland (First Amended Complaint), No. 505164-1 Fred Elwood, Joseph Galea, Michael Wildman and Ray Berry

Cheng v. Southland (First Amended Complaint), No. 505162-3 Gene Janssen, Curtis Pare, Ray Berry and Paul Stevenson

Keating v. Southland (First Amended Complaint), No. 505159-9 Ray D. Berry, Keith Jenkins and Robert Duncan

Battersby v. Southland, No. 390132 Ray Berry

Coy v. Southland (Second Amended Complaint), No. 506120-6 Ray Berry, Tal Colson and The Southland Corporation

Southland v. Scovis (Cross-Complaint), L.A.S.C. No. C235779 Ray D. Berry, Douglas Porter and The Southland Corporation

The Court having considered the arguments of counsel and all the papers, memoranda and briefs filed by the parties, and good cause appearing therefor,

IT IS HEREBY ORDERED that the petitions for order to arbitrate and motion for stay of proceedings in the *Gouveia, Garza, Sampson, Newell, Cheng, Keating* and *Battersby* cases be, and the same hereby are, GRANTED, with the exception of the claims based upon the California Franchise Investment Law, which claims are contained in the First Cause of Action of the Second Amended Complaint in the *Gouveia, Garza* and *Sampson* cases, and the First Cause of Action in the First Amended Complaint in the *Cheng* and *Newell* cases and the Second Cause of Action of the Complaint in the *Battersby* case, and the Second Cause of Action in the First Amended Complaint in the *Keating* case. To the extent that this order grants the petitions for order to compel arbitration, said petitions are granted on the condition that petitioners either abstain from the use of any discovery that they have had in any of the above actions, or that they stipulate to discovery of at least an equally extensive nature on behalf of the plaintiffs in those actions.

IT IS HEREBY FURTHER ORDERED that the petition for order to arbitrate and motion for stay of proceedings in the *Coy* and *Scovis* cases, because said actions are based upon claims under the California Franchise Investment Law, be, and the same hereby are, DENIED.

IT IS HEREBY FURTHER ORDERED that further proceedings as to petitioners in the *Gouveia, Garza, Sampson, Cheng, Newell, Keating* and *Battersby* cases, referred to above, be, and the same hereby are, stayed therein pending the outcome of such arbitration or until further order of this Court.

2. Southland and the individual defendants listed above in the above captioned coordinated actions have also filed demurrers to the Second Amended Complaints in the *Gouveia, Garza, Sampson* and *Coy* cases, and to the First Amended Complaints in the *Cheng, Newell* and *Keating* cases and to the Complaint in the *Battersby* case and to the Cross-Complaint in the *Scovis* case. The Court having considered these matters, and good c[illegible] appearing therefor,

IT IS HEREBY ORDERED that the demurrers be, and the same hereby are, OVERRULED, and Southland and the demurring individual defendants shall have up to and including 30 days from the date of this Order in which to file answers to the complaints as to those causes of action not ordered arbitrated which were the subject of the demurrers, notice of said ruling having been waived.

3. Defendants John P. Thompson, Jere W. Thompson, Walton Grayson, III, Joseph S. Hardin, R. G. Smith, Eugene Pender, S. R. Dole and Terry Debard in all of the above captioned cases (with the exception of S. R. Dole in the *Keating* and *Battersby* cases) moved for an order quashing service of summons on each of them. The Court having considered said motions, the arguments of counsel, and good cause appearing therefor,

IT IS HEREBY ORDERED that said motions be, and the same hereby are, DENIED.

4. The Southland Corporation has moved for an order to dismiss the Complaint without prejudice in *Southland* v. *Scovis*. Defendants Mr. and Mrs. Scovis objected to said dismissal and Southland withdrew said motion at the hearing.

Signed this 31st day of July 1978, in open court.

/S/ ROBERT H. KRONINGER
Judge of the Superior Court
and Coordination Trial Judge

APPENDIX F

SUPREME COURT OF THE STATE OF CALIFORNIA

S. F. No. 24242

Appeal

County of Alameda

Superior Court No. 469216-2

RICHARD D. KEATING et al.,

Petitioners

—v.—

SUPERIOR COURT, ALAMEDA COUNTY,

Respondent;

SOUTHLAND CORPORATION et al.,

EDWARD J. GOUVEIA et al.,

Plaintiffs and Respondents,

—v.—

SOUTHLAND CORPORATION et al.,

Defendants and Appellants.

[And 7 other cases*]

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* *Cheng v. Southland Corporation* (Super. Ct. No. 505162-3); *Newell v. Southland Corporation* (Super. Ct. No. 505164-1); *Sampson v. Southland Corporation* (Super. Ct. No. 505161-4); *Battersby v. Southland Corporation* (Super. Ct. No. 390132); *Keating v. Southland Corporation* (Super. Ct. No. 505159-9); *Coy v. Southland Corporation* (Super. Ct. No. 506120-6); and *Scovis v. Southland Corporation* (Super. Ct. No. C-235779).

The above-entitled cause having been heretofore fully argued, and submitted,

IT IS ORDERED, ADJUDGED, AND DECREED by the Court that the order of the Superior Court of the County of Alameda in the above-entitled cause, is hereby reversed and the cause is remanded for further proceedings consistent with the opinion herein. In light of our opinion, the petition for writ of prohibition or mandate is denied. Each party to bear their own costs.

I, LAURENCE P. GILL, Clerk of the Supreme Court of the State of California, do hereby certify that the foregoing is a true copy of an original judgment entered in the above-entitled cause on the 10th day of June, 1982.

WITNESS my hand and the seal of the Court, this 20th day of July, 1982

LAURENCE P. GILL
Clerk

By _____
Deputy

[SEAL]

APPENDIX G

IN THE SUPREME COURT OF
THE STATE OF CALIFORNIA

S.F. No. 24242

RICHARD D. KEATING, *et al.*,
Petitioners,

—v.—

THE SUPERIOR COURT OF ALAMEDA COUNTY,
Respondent.

THE SOUTHLAND CORPORATION, *et al.*,
Real Parties in Interest.

EDWARD J. GOUVEIA, *et al.*,
Plaintiffs and Respondents,

—v.—

THE SOUTHLAND CORPORATION, *et al.*,
Defendants and Appellants.

[And 7 Other Cases]*

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES
[Filed August 24, 1982]

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* *Cheng v. Southland Corporation* (Super. Ct. No. 505162-3); *Newell v. Southland Corporation* (Super. Ct. No. 505164-1); *Sampson v. Southland Corporation* (Super. Ct. No. 505161-4); *Battersby v. Southland Corporation* (Super. Ct. No. 390132); *Keating v. Southland Corporation* (Super. Ct. No. 505159-9); *Coy v. Southland Corporation* (Super. Ct. No. 506120-6); and *Scovis v. Southland Corporation* (Super. Ct. No. C-235779).

Notice is hereby given that The Southland Corporation, and those of its officers, directors and employees who were named as defendants in the court below, hereby appeal to the Supreme Court of the United States from the final judgment of the Supreme Court of the State of California, entered in this action on June 10, 1982, insofar as that judgment held that certain claims in this litigation were not subject to arbitration, and insofar as it held that plaintiffs could seek to have their arbitrable claims certified as a class action.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

Respectfully submitted,

ARNOLD & PORTER

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Dated: August 24, 1982

[Certificate of service omitted]

APPENDIX H

SUPREME COURT OF THE UNITED STATES

No. A-213

THE SOUTHLAND CORPORATION, ET AL.,

Petitioners/Appellants
(or Applicants)

—v.—

RICHARD D. KEATING, ET AL.

ORDER

UPON CONSIDERATION of the application of counsel for the petitioners/appellants (applicants),

IT IS ORDERED that the time for filing a petition for writ of certiorari and/or docketing an appeal in the above-entitled cause, be, and the same is hereby, extended to and including September 22, 1982.

/S/ WILLIAM H. REHNQUIST
Associate Justice of the Supreme
Court of the United States

Dated this 30th day of August, 1982.

APPENDIX 1

Constitutional and Statutory Provisions Involved

1. The Supremacy Clause, U.S. CONST. art. VI, cl. 2

This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

2. The Due Process Clause, U.S. CONST. amend. XIV, § 1

[N]or shall any State deprive any person of life, liberty, or property, without due process of law. . . .

3. The Federal Arbitration Act, 9 U.S.C. §§ 1-3 (1976)

§ 1. "Maritime transactions" and "Commerce" defined; exceptions to operation of title

"Maritime transactions", as herein defined, means charter parties, bills of lading of water carriers, agreements relating to wharfage, supplies furnished vessels or repairs to vessels, collisions, or any other matters in foreign commerce which, if the subject of controversy, would be embraced within admiralty jurisdiction; "commerce", as herein defined, means commerce among the several States or with foreign nations, or in any Territory of the United States or in the District of Columbia, or between any such Territory and another, or between any such Territory and any State or foreign nation, or between the District of Columbia and any State or Territory or foreign nation, but nothing herein contained shall apply to contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce.

§ 2. Validity, irrevocability, and enforcement of agreements to arbitrate

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

§ 3. Stay of proceedings where issue therein referable to arbitration

If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

4. The California Investment Franchise Law, Cal. Corp. Code § 31512 (West 1977)

Any condition, stipulation or provision purporting to bind any person acquiring any franchise to waive compliance with any provision of this law or any rule or order hereunder is void.

Office Supreme Court, U.S.
FILED
MAR 10 1983
ALEXANDER STEVAS,
CLERK

No. 82-500

IN THE
Supreme Court of the United States
OCTOBER TERM, 1982

THE SOUTHLAND CORPORATION, *et al.*,
Appellants,

—v.—

RICHARD D. KEATING, *et al.*,
Appellees.

On Appeal from the Supreme Court of California

JOINT APPENDIX

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March 1983

* Counsel of Record

APPEAL DOCKETED SEPTEMBER 22, 1982
JURISDICTION POSTPONED JANUARY 10, 1983

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NOTICE

The following materials have been omitted in printing this Joint Appendix because they appear on the following pages of the Appendix to the Jurisdictional Statement:

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Order of the Superior Court of the State of California in and for the County of Alameda re motions heard on July 19, 1978 (July 31, 1978)	77a
Opinion of the California Court of Appeal, First District (August 28, 1980), reported at 109 Cal. App. 3d 784, 167 Cal. Rptr. 481 (1980)	47a
Opinion of the Supreme Court of the State of California (June 10, 1982), reported at 31 Cal. 3d 584, 183 Cal. Rptr. 360, 645 P.2d 1192 (1982)	1a
Judgment and Decree of the Supreme Court of the State of California (June 10, 1982)	81a

LIST OF SIGNIFICANT DATES

CALIFORNIA JUDICIAL COUNCIL
COORDINATED PROCEEDING NO. 387

coordinating the following proceedings in the Superior Court of the State of California in and for the County of Alameda:

Keating, et al. v. *The Southland Corporation, et al.* (Super. Ct. No. 505159-9)

Gouveia, et al. v. *The Southland Corporation, et al.* (Super. Ct. No. 469216-2)

Battersby, et al. v. *The Southland Corporation, et al.* (Super. Ct. No. 390132)

Cheng, et al. v. *The Southland Corporation, et al.* (Super. Ct. No. 505162-3)

Coy, et. al. v. *The Southland Corporation, et al.* (Super. Ct. No. 506120-6)

Garza, et al. v. *The Southland Corporation, et al.* (Super. Ct. No. 505160-5)

Newell, et al. v. *The Southland Corporation, et al.* (Super. Ct. No. 505164-1)

Sampson, et al. v. *The Southland Corporation, et al.* (Super. Ct. No. 505161-4)

The Southland Corporation v. *Scovis, et al.* (Super. Ct. No. C-235779)

Date	Case	Proceedings—Filings
9/3/75	Gouveia (Ala. Co. Super. Ct.)	Complaint for Intentional and Negligent Misrepresentation; and for Rescission
9/12/75	Gouveia (USDC - N.D. Cal.)	Answer of Defendant The Southland Corporation to Complaint [accompanying petition for removal]
9/24/75	Gouveia (USDC - N.D. Cal.)	Amended Answer and Counterclaim of Defendant The Southland Corporation to Complaint
11/21/75	Gouveia (Ala. Co. Super. Ct.)	First Amended Complaint [following remand]
1/12/76	Gouveia (Ala. Co. Super. Ct.)	Answer of Defendant The Southland Corporation to First Amended Complaint
9/15/76	Garza (Santa Clara Co. Super. Ct.)	Complaint for Intentional and Negligent Misrepresentation and Breach of Contract
10/6/76	Sampson (Santa Clara Co. Super. Ct.)	Complaint for Intentional and Negligent Misrepresentation
10/25/76	Garza (Santa Clara Co. Super. Ct.)	Defendant The Southland Corporation's Answer to Complaint for Intentional and Negligent Misrepresentation and Breach of Contract
12/1/76	Cheng (Santa Clara Co. Super. Ct.)	Complaint for Intentional and Negligent Misrepresentation; Violation of Franchise Investment Law; Rescission; and Breach of Contract
12/31/76	Cheng (Santa Clara Co. Super. Ct.)	Answer of Defendant The Southland Corporation to Complaint for Intentional and Negligent Misrepresentation; Violation of Franchise Investment Law; Rescission; and Breach of Contract
1/4/77	Sampson (Santa Clara Co. Super. Ct.)	First Amended Complaint for Intentional and Negligent Misrepresentation

Date	Case	Proceedings—Filings
1/4/77	Newell (Santa Clara Co. Super. Ct.)	Complaint for Intentional and Negligent Misrepresentation; Violation of Franchise Investment Law; Rescission
2/3/77	Newell (Santa Clara Co. Super. Ct.)	Answer of Defendant The Southland Corporation to Complaint for Intentional and Negligent Misrepresentation; Violation of Franchise Investment Law; and Rescission; and Cross-Complaint of Defendant The Southland Corporation for Money Due on Account
2/16/77	Garza (Santa Clara Co. Super. Ct.)	First Amended Complaint
2/7/77	Sampson (Santa Clara Co. Super. Ct.)	Answer of Defendant The Southland Corporation to First Amended Complaint for Intentional and Negligent Misrepresentation
2/8/77	Sampson (Santa Clara Co. Super. Ct.)	Cross-Complaint of Defendant The Southland Corporation for Money Due on Account
3/7/77	Newell (Santa Clara Co. Super. Ct.)	[Newells'] Answer to Cross-Complaint for Money Due on Account
5/24/77	Keating (Santa Clara Co. Super. Ct.)	Complaint for Intentional Fraud, Negligent Fraud, Breach of Contract, Violation of the Franchise Investment Act and Declaratory Relief
6/13/77	Keating (USDC - N.D. Cal.)	Answer and Counterclaims of Defendant The Southland Corporation [accompanying petition for removal]
7/5/77	Keating (USDC - N.D. Cal.)	First Amended Answer and Counterclaims of Defendant The Southland Corporation

Date	Case	Proceedings—Filings
9/28/77	Keating (Santa Clara Co. Super. Ct.)	Notice of Hearing of Petition and Petition of The Southland Corporation for Order to Arbitrate, and Notice of Motion and Motion for Stay of Proceedings Pending Determination of Petition to Compel Arbitration and Pending Arbitration
10/6/77	Keating (Santa Clara Co. Super. Ct.)	Stipulation and Order for Change of Venue to Napa County Superior Court
10/19/77	Keating (Napa Co. Super. Ct.)	Notice of Hearing of Petition of The Southland Corporation for Order to Arbitrate, and Notice of Motion and Motion for Stay of Proceedings Pending Determination of Petition to Compel Arbitration and Pending Arbitration
10/20/77	Keating (Napa Co. Super. Ct.)	Answer of Defendant The Southland Corporation
12/5/77	Keating (Napa Co. Super. Ct.)	Plaintiffs' Brief in Opposition to Defendant's Motion to Compel Arbitration
12/12/77	Keating (Santa Clara Co. Super. Ct.)	The Southland Corporation's Reply to Plaintiffs' Brief in Opposition to Defendant's Motion to Compel Arbitration
12/13/77	Battersby (Santa Clara Co. Super. Ct.)	Complaint for Breach of California Franchise Investment Law, Declaratory Relief, Usury, Breach of Contract, Breach of Fiduciary Duty, Injunctive Relief, Fraud and Negligent Misrepresentation and Conspiracy (Class Action)
12/16/77	All Cases (Santa Clara Co. Super. Ct.)	Minute Order [postponing ruling on motion to compel arbitration]

Date	Case	Proceedings—Filings
12/19/77	All Cases (Santa Clara Co. Super. Ct.)	Order Granting Coordination Petition
1/19/78	All Cases (Judicial Council of California)	Order Assigning Coordination Trial Judge
1/20/78	Keating (Coord. Proc. No. 387)	Notice of Hearing of Petition of The Southland Corporation for Order to Arbitrate
1/25/78	All Cases (Judicial Council of California)	Order for Transfer and Procedure
1/26/78	Keating (Napa Co. Super. Ct.)	Plaintiffs' Supplemental Memorandum in Opposition to Motion to Compel Arbitration
1/30/78	Garza, Gouveia, Sampson (Coord. Proc. No. 387)	Second Amended Complaint: Breach of California Franchise Investment Law, Declaratory Relief, Usury, Breach of Contract, Breach of Fiduciary Duty, Injunctive Relief, Fraud and Negligent Misrepresentation and Conspiracy
1/30/78	Cheng, Keating, Newell (Coord. Proc. No. 387)	First Amended Complaint: Breach of California Franchise Investment Law, Declaratory Relief, Usury, Breach of Contract, Breach of Fiduciary Duty, Injunctive Relief, Fraud and Negligent Misrepresentation and Conspiracy [1]
2/3/78	Keating (Coord. Proc. No. 387)	Minute Order re Arbitration
2/16/78	Keating (Coord. Proc. No. 387)	Order re Petition for Order to Arbitrate [2]

[1] Amended Complaint in *Keating* reprinted at J.A. 12.

[2] Reprinted at J.S. App. 71a.

Date	Case	Proceedings—Filings
2/24/78	Cheng, Garza, Gouveia, Newell, Sampson (Coord. Proc. No. 387)	Notice of Hearing of Petition and Petition of The Southland Corporation for Order to Arbitrate, and Notice of Motion and Motion for Stay of Proceedings Pending Arbitration [separate petition for each named case]
3/27/78	Coy (Ala. Co. Super. Ct.)	Complaint (Class Action Alleged) for Breach of the California Franchise Investment Law
4/4/78	Keating (Coord. Proc. No. 387)	Notice of Appeal [of The Southland Corporation from Minute Order of 2/3/78 and Order of 2/16/78 re Denial of Arbitration]
4/4/78	Scovis (Los Angeles Co. Super. Ct.)	Complaint of The Southland Corporation for Possession of Collateral, Injunctive Relief, Appointment of a Receiver and Damages
4/6/78	Cheng, Garza, Gouveia, Newell, Sampson (Coord. Proc. No. 387)	Plaintiffs' Memorandum of Points and Authorities in Opposition to Southland's Motion to Compel Arbitration
4/10/78	Coy (Ala. Co. Super. Ct.)	First Amended Complaint (Class Action Alleged) for Breach of the California Franchise Investment Law
4/12/78	Scovis (Los Angeles Co. Super. Ct.)	Answer to Complaint and Cross-Complaint for Breach of California Investment Law; Declaratory Relief
4/21/78	Cheng, Garza, Gouveia, Newell, Sampson (Coord. Proc. No. 387)	Reply Memorandum of Defendant The Southland Corporation in Support of Motion to Compel Arbitration

Date	Case	Proceedings—Filings
5/5/78	Battersby, Cheng, Garza, Gouveia, Newell, Sampson (Coord. Proc. No. 387)	Order re Motions Heard on April 26, 1978 [3]
5/11/78	Coy (Ala. Co. Super. Ct.)	Second Amended Complaint (Class Action Alleged) for Breach of the California Franchise Investment Law
5/19/78	Battersby, Cheng, Garza, Gouveia, Newell, Sampson (Coord. Proc. No. 387)	Notice of Appeal [of The Southland Corporation from Order of 5/5/78 Denying Arbitration]
6/12/78	Battersby (Coord. Proc. No. 387)	Defendant The Southland Corporation's Answer to Complaint
6/12/78	Cheng, Keating, Newell (Coord. Proc. No. 387)	Defendant The Southland Corporation's Answer to First Amended Complaint [separate answer in each case] [4]
6/12/78	Garza, Gouveia, Sampson (Coord. Proc. No. 387)	Defendant The Southland Corporation's Answer to Second Amended Complaint [separate answer in each case]
6/16/78	Battersby, Cheng, Garza, Gouveia, Keating, Newell, Sampson (Coord. Proc. No. 387)	Notice of Hearing of Petition and Petition [of Employee-Defendants] for Order to Arbitrate, and Notice of Motion and Motion for Stay of Proceedings Pending Arbitration
6/16/78	Coy, Scovis (Coord. Proc. No. 387)	Notice of Hearing of Petition and Petition [of The Southland Corporation] for Order to Arbitrate, and Notice of Motion and Motion for Stay of Proceedings Pending Arbitration

[3] Reprinted at J.S. App. 73a.

[4] Answer in *Keating* reprinted at J.A. 26.

Date	Case	Proceedings—Filings
7/17/78	Battersby, Cheng, Garza, Gouveia, Keating, Newell, Sampson (Coord. Proc. No. 387)	Plaintiffs' Opposition to Petition for Order to Arbitrate Disputes
7/17/78	Coy, Scovis (Coord. Proc. No. 387)	Plaintiffs' Memorandum of Points and Authorities in Opposition to Defendants' Petition to Compel Arbitration and Motion to Stay Proceedings
7/18/78	Coy, Scovis (Coord. Proc. No. 387)	Reply of Defendants and Petitioners to Plaintiffs' Memorandum of Points and Authorities in Opposition to Petition to Compel Arbitration and Motion to Stay Proceedings
7/31/78	All Cases (Coord. Proc. No. 387)	Order re Motions Heard on July 19, 1978 [5]
8/16/78	All Cases (Coord. Proc. No. 387)	Notice of Appeal [of The Southland Corporation and Employee-Defendants from Order of 7/31/78 Denying Arbitration]
9/22/78	All Cases (Coord. Proc. No. 387)	Stipulation re Petition to Arbitrate, Motion to Stay Proceedings and Demurrer
9/25/78	All Cases (Coord. Proc. No. 387)	Minute Order [re Stipulation of 9/22/78]
10/3/78	Coy (Coord. Proc. No. 387)	Answer of Defendant The Southland Corporation and Individual Defendants to Second Amended Complaint
10/3/78	Scovis (Coord. Proc. No. 387)	Answer of Defendant The Southland Corporation and Individual Defendants to Cross-Complaint

[5] Reprinted at J.S. App. 77a.

Date	Case	Proceedings—Filings
10/3/78	Cheng, Garza, Gouveia, Keating, Newell, Sampson (Cal. Ct. App., First Dist., Div. Three)	[Plaintiffs'] Petition for Writs of Mandate or Prohibition; Memorandum of Points and Authorities
10/3/78	All Cases (Coord. Proc. No. 387)	Notice of Appeal [of Employee-Defendants from Minute Order of 9/25/78 Denying Arbitration]
1/5/79	Cheng, Garza, Gouveia, Keating, Newell, Sampson (Cal. Ct. App., First Dist., Div. Three)	[Defendants'] Memorandum of Points and Authorities in Opposition to Petition for Writs of Mandate or Prohibition
4/9/79	All Cases (Cal. Ct. App., First Dist., Div. Three)	Opening Appellate Brief of Appellants The Southland Corporation and Employee-Defendants
4/26/79	Cheng, Garza, Gouveia, Keating, Newell, Sampson (Cal. Ct. App., First Dist., Div. Three)	Order [granting alternative writ of mandate]
5/24/79	All Cases (Cal. Ct. App., First Dist., Div. Three)	Order Consolidating Appeals
6/4/79	All Cases (Cal. Ct. App., First Dist., Div. Three)	Plaintiffs'-Respondents' Brief
7/2/79	All Cases (Cal. Ct. App., First Dist., Div. Three)	Answer to Petition for Writs of Mandate or Prohibition [of Real Parties in Interest The Southland Corporation and Employee-Defendants]

Date	Case	Proceedings—Filings
7/2/79	All Cases (Cal. Ct. App., First Dist., Div. Three)	Supplemental Memorandum of Points and Authorities in Opposition to Petition for Writs of Mandate or Prohibition and Appellants' Reply Brief [of The Southland Corporation and Employee-Defendants]
7/10/79	All Cases (Cal. Ct. App., First Dist., Div. Three)	Petitioners-Plaintiffs' Supplemental Memorandum in re Arbitration in a Class Action
8/28/80	All Cases (Cal. Ct. App., First Dist., Div. Three)	Opinion [6]
9/12/80	All Cases (Cal. Ct. App., First Dist., Div. Three)	[Plaintiffs'] Petition for Rehearing
9/19/80	All Cases (Cal. Ct. App., First Dist., Div. Three)	[Defendants'] Answer to Petition for Rehearing
9/26/80	All Cases (Cal. Ct. App., First Dist., Div. Three)	Order Denying Petition for Rehearing
10/7/80	All Cases (Cal. Sup. Ct.)	Petition for Hearing [of The Southland Corporation and Employee-Defendants]
10/17/80	All Cases (Cal. Sup. Ct.)	[Plaintiffs'] Answer to Petition for Hearing
11/19/80	All Cases (Cal. Sup. Ct.)	Petition for Hearing Granted

[6] Reprinted at J.S. App. 47a.

Date	Case	Proceedings—Filings
1/9/81	All Cases (Cal. Sup. Ct.)	[Defendants'] Reply Brief to [Plaintiffs'] Answer to Petition for Hearing
1/26/81	All Cases (Cal. Sup. Ct.)	Plaintiffs' Response to Southland's Reply Brief
2/2/81	Garza (Cal. Sup. Ct.)	Order Dismissing *Garza* v. *The Southland Corporation* with Prejudice [pursuant to stipulation]
6/10/82	All Cases (Cal. Sup. Ct.)	Opinion [7]
8/24/82	All Cases (Cal. Sup. Ct.)	Notice of Appeal [of The Southland Corporation and Employee-Defendants] to the Supreme Court of the United States [8]
1/10/83	All Cases (U.S. Sup. Ct.)	Order [postponing determination of jurisdiction] [9]

[7] Reprinted at J.S. App. 1a.

[8] Reprinted at J.S. App. 83a.

[9] Reprinted at J.A. 86.

[Names of Attorneys for Plaintiffs Omitted in Printing]

SUPERIOR COURT OF THE STATE OF CALIFORNIA
FOR THE COUNTY OF NAPA

No. 37402

RICHARD D. KEATING, DARLA J. KEATING, on behalf of themselves, and all other similarly situated, and as individuals,

Plaintiffs,

vs.

THE SOUTHLAND CORPORATION, a corporation, KEITH JENKINS; RAY D. BERRY; TERRY DEBARD; JOHN P. THOMPSON; JERE W. THOMPSON; WALTON GRAYSON III; JOSEPH S. HARDIN; R. G. SMITH; EUGENE PENDER; ROBERT DUNCAN; and DOES TEN through FIVE HUNDRED, inclusive,

Defendants.

FIRST AMENDED COMPLAINT (CLASS ACTION ALLEGED) FOR BREACH OF THE CALIFORNIA FRANCHISE INVESTMENT LAW, DECLARATORY RELIEF, USURY, BREACH OF CONTRACT, BREACH OF FIDUCIARY DUTY, INJUNCTIVE RELIEF, FRAUD AND NEGLIGENT MISREPRESENTATION AND CONSPIRACY

[Filed January 30, 1978]

Plaintiffs Richard D. Keating and Darla J. Keating, on behalf of themselves and all others similarly situated, allege as follows:

GENERAL ALLEGATIONS

1. Each and every allegation in these general allegations, paragraphs 1 through 11, are by this reference incorporated into each and every cause of action herein as if fully set forth therein.

Plaintiffs Richard D. Keating and Darla J. Keating reside in the County of Napa, State of California. The defendant The Southland Corporation, a corporation (hereinafter "Southland"), was, at all times material hereto, doing business under the name of 7-Eleven within the State of California and within the County of Napa. The defendants Keith Jenkins, and Ray D. Berry and Robert Duncan, sued as Doe 1 and Doe 9, respectively, are individuals, who, at all times material hereto, were residing within the State of California. The defendants at all times material hereto, were each the agents and/or employees of each of the other defendants herein and each were at all times material hereto acting within the scope of said agency and employment.

The defendants Terry DeBard, John P. Thompson, Jere W. Thompson, Walton Grayson III, Joseph S. Hardin, R. G. Smith and Eugene Pender are employees, officers and directors who actually, and as a matter of law, participated in each and every act of misconduct of defendants alleged herein.

The true names and capacities, whether individual, corporate, associate or otherwise, of defendants Does Ten through Five Hundred, inclusive, are unknown to plaintiffs and are therefore sued by such fictitious names. Plaintiffs will amend this complaint to show their true names and capacities when they have been ascertained.

2. On or about August 5, 1974, plaintiffs Richard D. Keating and Darla J. Keating and defendant Southland entered into a standard form of written agreement employed by Southland in the franchising of all 7-Eleven stores in California, by the terms of which Southland became a franchisor of and plaintiffs became a franchisee of a convenience-type grocery store, doing business under the name of 7-Eleven and known as store No. 2211-14135 E, located at 2010 Redwood Road, Napa, California (hereinafter "the store"). The written agreement referred to hereinabove is entitled as follows: 7-Eleven

Training Agreement, 7-Eleven Store Agreement, Lease Agreement (attached to Store Agreement as Exhibit "A"), and Exhibits B through F to the said Store Agreement, "Credit Card Sales" and the Security Agreement (hereinafter "7-Eleven Agreement").

3. A class action is hereby alleged pursuant to California Code of Civil Procedure, Section 382.

4. The class (hereinafter "class") consists of all persons in the State of California who are or were (within the last four years prior to the filing of this action) franchise owners of Southland's 7-Eleven stores. Each of said persons has entered into an agreement with Southland identical in all material respects to the 7-Eleven Agreement.

5. Plaintiffs are members of said class; their claims are typical of the claims of all class members. They will fairly and adequately protect the interests of the class.

6. There exist herein as to all members of the class common questions of fact, including the validity and interpretation of provisions in the standard form of 7-Eleven Agreement between members of the class and Southland. Said 7-Eleven Agreement is a standardized contract form which constitutes a contract of adhesion in that it is offered to plaintiffs and to class members on a "take it or leave it" basis without affording plaintiffs or class members a realistic opportunity to bargain and under such conditions that plaintiffs and class members could not secure franchises except by acquiescing in said agreement. The common issues of fact further include the validity of the arbitration clause contained in the 7-Eleven Agreement.

7. There exist common questions of law, including, without limitation, the validity of the arbitration clause of the 7-Eleven Agreement, the accounting issues set

forth in the fourth cause of action, whether the "late charge" (our phrase) set forth in Article 17(h) of the "7-Eleven Store Agreement" is an illegal penalty; and whether Southland may freely and without charge commingle its funds with those held in trust for members of the class.

8. The class includes at least 800 persons, and can readily be identified from the records of Southland. Joinder of all class members is impracticable.

9. The questions of law and fact which are common to members of the class predominate over questions affecting only individual members.

10. A class action is superior to other available methods for the fair and efficient adjudication of the controversy.

11. Pursuant to the 7-Eleven Agreement, each class member must deliver promptly all of the cash and other receipts of the franchised store to the care, custody and control and trust of Southland, and the individual defendants, and each of them. Southland, through its agents, including the individual defendants, and each of them, agrees to hold and disburse said funds solely for the benefit of the members of the class as provided for in said 7-Eleven Agreement. Each and every alleged breach of fiduciary duty, breach of contractual obligation, and each and every allegation of dispute set forth in the cause of action for declaratory relief, and each and every allegation of breach of the California Franchise Investment Law, and further, each and every injunctive relief sought, each willful misrepresentation and negligent misrepresentation and act of conspiracy which is alleged herein, arise directly out of or in some material way are related to the terms and conditions of the said 7-Eleven Agreement.

FIRST CAUSE OF ACTION

(Declaratory Relief—Arbitration Clause)

12. The 7-Eleven Agreement constitutes a "franchise" within the meaning of the California Franchise Investment Law (Corporations Code section 31,000 et seq.).

13. The 7-Eleven Agreement provides that controversies or claims arising out of or relating to said agreement or the breach thereof shall be settled by arbitration.

14. The arbitration clause in the 7-Eleven Agreement is intended to limit the duties and liabilities of Southland to plaintiffs and to members of the class by depriving plaintiffs and class members of their constitutional right to a trial by jury and of statutory rights, including discovery and other procedural safeguards afforded by California law.

15. Southland contends that said arbitration clause embraces, and bars judicial litigation of, the claims of plaintiffs and the class that Southland has violated the California Franchise Investment Law by inducing them to enter into the 7-Eleven Agreement by means of false statements and omissions. Plaintiffs contend on the contrary that said arbitration clause constitutes a condition, stipulation or provision purporting to require members of the class to waive rights under the Franchise Investment Law and that said clause is therefore void under Corporations Code section 31512.

16. The arbitration clause was presented to plaintiffs and to members of the class without a plain and clear notification of the terms and effect thereof and, consequently, without having secured their understanding consent thereto. The terms thereof and the important limitations imposed thereby on the duties and liabilities of Southland are beyond the reasonable expectations of the ordinary person and are oppressive and unconscionable.

17. An actual controversy has arisen and now exists between plaintiffs and the class, on the one hand, and Southland, on the other, concerning the validity and enforceability of the said arbitration clause.

WHEREFORE, plaintiffs pray judgment as hereinafter set forth.

SECOND CAUSE OF ACTION

(Violation of Franchise Investment Law)

18. The 7-Eleven Agreement constitutes a "franchise" within the meaning of the California Franchise Investment Law (Corporations Code sections 31000 et seq.).

19. Under Section 31101 of the Corporations Code, defendants were required to disclose in writing to plaintiffs and the class, at least 48 hours prior to their execution of the 7-Eleven Agreement, certain statutory information, including a statement of the franchise fee charged, the proposed application of the proceeds of such fee by the franchisor, and, if the fee is not the same in all cases, the formula by which the amount of the fee is determined. Said section further requires that, if any statement of estimated or projected franchise earnings is used, the statutory disclosure statement must state that estimation or projection, as well as the data upon which it is based.

20. Corporations Code section 31202 provides that it is unlawful for any person willfully to make any untrue statement of a material fact in any statement required to be disclosed under section 31101, above, or willfully to omit to state in any such statement any material fact which is required to be stated therein.

21. Corporations Code section 31201 provides that it is unlawful for any person to sell a franchise in this state by means of any written or oral communication which includes an untrue statement of a material fact

or omits to state a material fact necessary in order to make the statements made, in the light of the circumstances in which they were made, not misleading.

22. Plaintiffs are informed and believe and based upon such information and belief allege that defendants have systematically violated section 31202 of the Corporations Code by willfully making untrue statements of material fact, and willfully omitting to state material facts which are required to be stated in statements required to be disclosed under section 31101, in the following respects:

(a) Southland's section 31101 disclosure statement contains untrue statements of material fact respecting the formula by which the 7-Eleven franchise fee is determined, in that said disclosure statement represents that discounts of various kinds from suppliers will be distributed to franchisees and no fee charged thereon, whereas in fact a franchise fee equal to approximately 50% of said discounts have been systematically charged to the class.

(b) Said statement contains purported average earnings from purportedly representative 7-Eleven stores but omits to disclose that a substantial number of stores have regularly earned less than said averages, as more fully alleged below.

23. Plaintiffs are informed and believe and based upon such information and belief allege that defendants have systematically violated section 31201 of the Corporations Code by selling franchises to plaintiffs and members of the class by means of written forms, uniformly utilized within each franchise sales area, which omit to state material facts necessary in order to make the statements made, in the light of the circumstances in which they were made, not misleading, and upon which plaintiffs and members of the class relied in purchasing franchises from defendants, as follows:

(a) Defendants' standard form sales brochure contains purported summaries of the average earnings of existing Southland franchises in each district entitled "Statement of Actual Average Earnings of all Franchised Seven Eleven Stores in District No. —— . . . and Operated Throughout the Period by a Single Franchisee." In fact, such "actual average earnings" are misleading, distorted and incomplete, in that they fail to disclose the substantially lower sales and income of a substantial number of stores in each sales area which have not, because of frequent franchisee turnover, been "operated throughout the period by a single franchisee." Plaintiffs are informed and believe and based upon such information and belief allege that stores in the latter category represent a substantial part of the total 7-Eleven stores in each district.

(b) Defendants' standardized brochures further represent that "all discounts and allowances for quantity purchases, in-store display of merchandise, promotions, and advertising, traceable to your sales or purchases, are distributed to owners by crediting costs of goods sold." That statement is false and misleading in that "all discounts" are not distributed to owners, but rather 50% or more thereof are collected by Southland as part of its franchise fee.

(c) Said sales brochures uniformly represent that "inventory shortage [will be] charged to you at cost." Said statement is false in that inventory shortage is not charged to members of the class at cost, but rather by method of a computation which artificially increases the cost of said merchandise so that a higher figure than its cost is charged to members of the class, and further because such inventory shortage results in a higher fee payable to Southland.

24. By reason of the foregoing, plaintiffs and the class have been damaged in an amount which plaintiffs are informed and believe and based thereon allege is in excess of ten million dollars ($10,000,000).

WHEREFORE, plaintiffs pray judgment as hereinafter set forth.

THIRD CAUSE OF ACTION

(Fraud—Rescission)

25. Plaintiffs reallege and incorporate by reference the allegations of the second cause of action.

26. The representations and omissions alleged in paragraph 22 and 23 are false and misleading. Defendants either knew that said representations and omissions were false and misleading at the time they were made, or knew that they did not have a reasonable basis in fact for making said representations and omissions.

27. Said representations and omissions were material to franchisees of 7-Eleven stores and to plaintiffs and members of the class. As a consequence of said material representations and omissions, plaintiffs and members of the class entered into the 7-Eleven Agreement.

28. Said representations and omissions were made by defendants with intent to induce plaintiffs and members of the class to enter into the 7-Eleven Agreement and with intent maliciously to deceive and oppress plaintiffs and members of the class.

WHEREFORE, plaintiffs pray judgment as hereinafter set forth.

FOURTH CAUSE OF ACTION

(Declaratory Relief and Accounting)

29. An actual controversy has arisen and exists between plaintiffs and the class, on the one hand, and Southland, on the other, concerning their respective rights and duties under the 7-Eleven Agreement in these respects:

(a) Whether the "late charge" provided in said agreements is valid and enforceable or whether it is an invalid penalty;

(b) Whether under Southland's accounting system, Southland has improperly and systematically charged plaintiffs and the class interest at the rate of 10% per annum on advances purportedly made by Southland to pay the invoices of their suppliers for periods of time preceding the actual payment of said invoices by Southland;

(c) Whether Southland has systematically charged plaintiffs and the class usurious interest in excess of 10% per annum on advances by Southland to suppliers, by virtue of Southland's practice of prematurely debiting the accounts of franchisees for such advances prior to the time of their actual payment and by computing interest at the rate of 10% per annum on the balance in the accounts so prematurely debited;

(d) Whether Southland has improperly collected for itself, through its franchise fee, a major portion of the discounts and allowances required by contract to be passed on to plaintiffs and members of the class;

(e) Whether Southland has breached a duty to plaintiffs and members of the class to make prompt payment to suppliers so as to secure prompt payment discounts and thereby deprived plaintiffs and members of the class of discounts to which they are entitled;

(f) Whether Southland has improperly overcharged plaintiffs and members of the class in respect to inventory shortages and inventory variations by charging more than the cost thereof to plaintiffs and members of the class;

(g) Whether Southland has charged plaintiffs and members of the class an improper and excessive franchise fee by virtue of its use of a method of valuing inventory which falsely increases the value thereof beyond its actual cost and thereby increases the franchise fees payable to Southland.

30. Southland contends that the controversies respecting contract interpretation and accounting set forth in the preceding paragraph 29 must be decided in its favor. Plaintiffs and the class contend to the contrary.

31. Plaintiffs and the class desire a judicial determination of their rights and duties and the rights and duties of Southland under the 7-Eleven Agreement with respect to the above controversies and for an accounting of all moneys determined to have been improperly collected by Southland.

WHEREFORE, plaintiffs pray judgment as hereinafter set forth.

FIFTH CAUSE OF ACTION

(Breach of Contract)

32. Plaintiffs reallege and incorporate by reference paragraph 29.

33. In breach of the 7-Eleven Agreement, Southland has charged plaintiffs and the class with each of the items alleged in paragraph 29 in the manner therein alleged.

34. The 7-Eleven Agreement, interpreted as required by law and pursuant to the principles applicable to contracts of adhesion and in light of Southland's implied obligation of good faith and fair dealing, imposes on Southland a duty not to charge the items alleged in paragraph 29 in the manner therein alleged, and said charges constitute a breach of the 7-Eleven Agreement.

35. As a result thereof, plaintiffs and the class have been damaged in an amount which is presently unknown but may be fixed by an accounting.

WHEREFORE, plaintiffs pray judgment as hereinafter set forth.

SIXTH CAUSE OF ACTION

(Breach of Fiduciary Duty)

36. Upon the 7-Eleven Agreement, plaintiffs and the class are required to, and have, deposited with Southland all cash receipts realized by them through the operation of 7-Eleven stores. At all times material hereto, Southland was in a fiduciary relationship with plaintiffs and the class and owed them a fiduciary duty to deal with said deposited funds according to the highest standards of care, not to deal adversely with said funds and, in the use thereof, not to prefer its own interest over the interests of plaintiffs and the class.

37. Nothwithstanding the fiduciary duty and obligations undertaken by Southland, Southland converted funds belonging to plaintiffs and the class to its own use and breached its contractual and fiduciary duties in the following particulars:

(a) Southland has failed to maintain in a separate account the funds deposited with Southland by the class and said funds have been commingled with the funds of Southland and used by Southland for its own benefit.

(b) Plaintiffs are informed and believe and based upon such information and belief allege that Southland has entered into payment arrangements with vendors of merchandise to members of the class providing that Southland may delay payment to such vendors, so that the funds deposited with Southland may be used by it without interest for periods of 30 to 90 days; and that Southland has so delayed said payment and has so used said funds.

(c) Plaintiffs are informed and believe and based upon such information and belief allege that Southland has systematically charged the accounts of members of the class with an interest charge based upon the amounts invoiced by vendors, although Southland had not yet paid said vendors.

(d) Plaintiffs are informed and believe and based upon such information and belief allege that Southland has systematically charged plaintiffs and the class usurious interest in excess of 10% per annum on advances by Southland to suppliers, by virtue of Southland's practice of prematurely debiting the accounts of franchisees for such advances prior to the time of their actual payment and by computing interest at the rate of 10% per annum on the balance in the accounts so prematurely debited.

38. Plaintiffs are informed and believe that the total damage arising out of said misconduct to the members of the class exceed $100,000 per week and that a sum in excess of $5,000,000 per week has been diverted to Southland's own use and benefit to be later paid into said fund through the customary accounting for the accounts of plaintiffs and members of the class.

39. In doing the acts complained of herein, Southland is guilty of fraud, oppression and malice and is therefore liable for punitive and exemplary damages in a sum in excess of $25,000,000.

WHEREFORE, plaintiffs pray judgment as follows:

(1) On the first cause of action, for a declaration pursuant to Code of Civil Procedure section 1060 of the respective rights and duties of the parties;

(2) On the second cause of action, for compensatory damages in an amount as alleged therein or according to proof at trial;

(3) On the third cause of action, for restitution of all sums expended by plaintiffs and members of the class by reason of their having entered into the 7-Eleven Agreement;

(4) On the fourth cause of action, for a declaration pursuant to Code of Civil Procedure section 1060 of the respective rights and duties of the parties for an accounting of all moneys determined to have been improperly

collected by Southland, and for a refund of all interest paid in violation of the usury laws together with treble damages thereon as provided by law;

(5) On the fifth cause of action, for damages as alleged therein or according to proof at trial;

(6) On the sixth cause of action, actual damages according to proof, for a refund of all interest paid in violation of the usury laws together with treble damages thereon as provided by law, and for punitive damages of $25,000,000;

(7) For costs of suit and attorneys' fees;

(8) For such other relief as the court determines to be proper.

Dated:

CARROLL, BURDICK & MCDONOUGH
ROBERT M. BROWN LAW CORPORATION
STARK, STEWART, SIMON & SPARROWE

by _____
Attorneys for Plaintiffs and the Class

[Verification Omitted in Printing]

[Names of Attorneys for Defendant Omitted in Printing]

IN THE SUPERIOR COURT OF THE
STATE OF CALIFORNIA
IN AND FOR THE COUNTY OF ALAMEDA

Coordination Proceeding
Special Title (Rule 1550(b))

MARKET FRANCHISE CASES

JUDICIAL COUNCIL
COORDINATION PROCEEDING
No. 387

[List of Coordinated Cases Omitted in Printing]

Relating to: KEATING v. SOUTHLAND,
Alameda Superior Ct. No. 505159-9

DEFENDANT THE SOUTHLAND CORPORATION'S ANSWER TO FIRST AMENDED COMPLAINT

[Filed June 12, 1978]

Defendant THE SOUTHLAND CORPORATION (hereinafter "Southland") for itself alone answers the First Amended Complaint ("Complaint") filed January 30, 1978 as follows:

ANSWER TO GENERAL ALLEGATIONS

1. As to the allegations hereinafter denied in this Answer for lack of information or belief, Southland has no information or belief on the subject of such allegations sufficient to enable it to answer such allegations so denied and, placing its denial on that ground, denies each and every allegation.

2. Answering the allegations contained in paragraph 1, Southland admits that plaintiffs reside in the County of Napa in the State of California; admits that Southland was at all times material hereto doing business under the name 7-Eleven within the State of California and within the County of Napa; admits that defendants Jenkins, Berry, and Duncan are individuals; admits that defendants DeBard, Thompson (John), Thompson (Jere), Grayson, Hardin, Smith and Pender are employees, officers, and/or directors of Southland; denies for lack of information or belief the allegations commencing at page 2, line 21 through 26; and except as so admitted and denied for lack of information or belief, denies each and every allegtion thereof.

3. Answering the allegations contained in paragraph 2, Southland admits that on the date indicated therein it entered into with plaintiffs the 7-Eleven Training Agreement, the 7-Eleven Store Agreement, including the exhibits thereto, and the Security Agreement for the store set forth therein; and except as so admitted, denies each and every allegation thereof.

4. Answering the allegations contained in paragraphs 3, 4, 5, 6, 7, 8, 9, and 10, Southland denies each and every allegation contained therein.

5. Answering the allegations contained in paragraph 11, Southland admits and alleges that the 7-Eleven Agreement entered into on August 5, 1974 required Owners to deposit daily all merchandise sales and money order receipts, discounts received by Owners and miscellaneous income from Owners' Operation (the "Sales Receipts") (except such of the Sales Receipts as have been expended in cash by Owners for Purchases or for Operating Expenses and so reported to 7-ELEVEN), in a bank, or the night depository thereof, designated by 7-ELEVEN, and deliver to 7-ELEVEN, on such days as may be designated by 7-ELEVEN, a verified duplicate deposit receipt

therefor bearing said bank's stamp; or where requested by 7-ELEVEN, deliver the Sales Receipts (except those as provided above) to an authorized representative of, or a person designated by, 7-ELEVEN on such days as may be designated by 7-ELEVEN; and under said agreement, said deposits were credited to Owners' open account. Except as so admitted and alleged, Southland denies each and every allegation thereof.

ANSWER TO THE ALLEGED
FIRST CAUSE OF ACTION

6. The First Cause of Action has already been adjudicated and no answer to this cause of action is therefore necessary at this time. In addition, pursuant to stipulation between counsel for plaintiffs and counsel for Southland, no answer or affirmative defenses to the alleged First Cause of Action need be filed at this time.

ANSWER TO THE ALLEGED
SECOND CAUSE OF ACTION

7. Answering the allegations contained in paragraph 18, Southland admits the allegations therein and further admits and alleges that it is exempt from the California Franchise Investment Law by virtue of section 31101 of the California Corporations Code.

8. Answering the allegations contained in paragraph 19, Southland admits and alleges that from and after January 1, 1971, the effective date of the California Franchise Investment Law, California Corporations Code section 31101 provided that in order to be exempt under certain provisions thereof, a franchisor must, *inter alia*, disclose in writing to each prospective franchisee, at least 48 hours prior to the execution by the prospective franchisee of a franchise Agreement, or at least 48 hours prior to the receipt of any consideration, the following information: 1) A statement of the franchise fee charged,

the proposed application of the proceeds of such fee by the franchisor, and the formula by which the amount of the fee is determined if the fee is not the same in all cases; and 2) if any statement of estimated or projected franchisee earnings is used, a statement of such estimation or projection and the data upon which it is based.

9. Paragraph 20 does not call for an answer. However, answering the allegations of paragraph 20, Southland admits that California Corporations Code section 31202 provides: "It is unlawful for any person willfully to make any untrue statement of a material fact in any statement required to be disclosed in writing pursuant to Section 31101, or willfully to omit to state in any such statement any material fact which is required to be stated therein."

10. Paragraph 21 does not call for an answer. However, answering paragraph 21, Southland admits that California Corporations Code section 31201 provides: "It is unlawful for any person to offer or sell a franchise in this state by means of any written or oral communication not enumerated in section 31200 which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading."

11. Answering the allegations contained in paragraphs 22, 22(a), 22(b), 23, 23(a), 23(b), 23(c) and 24, Southland denies each and every allegation contained therein, and specifically denies that defendants have in any manner whatsoever violated the California Franchise Investment Law, including, but not limited to, sections 31101 and 31200-31202, thereof, and further denies that plaintiffs are entitled to the damages alleged in paragraph 24 or any sums or damages whatsoever.

ANSWER TO THE ALLEGED THIRD THROUGH SIXTH CAUSES OF ACTION

12. Pursuant to stipulation of counsel, no answer need be made to the alleged third through sixth causes of action since the Court has ordered these claims arbitrated.

As affirmative defenses to the alleged Second Cause of Action only, and without waiving its right to assert affirmative defenses to the other alleged causes of action at some later time if it becomes necessary, Southland alleges as follows:

FIRST AFFIRMATIVE DEFENSE

(Failure of Complaint to State Claim for Relief)

13. As a separate and First Affirmative Defense to the alleged Second Cause of Action of the Complaint, Southland alleges that said cause of action does not set forth facts sufficient to state any claim for relief against it.

SECOND AFFIRMATIVE DEFENSE

(Waiver)

14. As a second, separate and affirmative defense to the alleged Second Cause of Action of the Complaint, Southland is informed and believes, and upon that basis alleges that plaintiffs, and each of them, have waived their right, if any they had, to any relief for recovery of damages on the basis of violations of the California Franchise Investment Law. At or before the time of trial of the within lawsuit, this answering defendant will seek leave of court to amend this answer to set forth such acts and conduct on the part of plaintiffs as may then be known to this answering defendant in support of this affirmative defense.

THIRD AFFIRMATIVE DEFENSE

(California Corporations Code Sections 31300 and 31301)

15. As a separate and Third Affirmative Defense to the alleged Second Cause of Action of the Complaint, Southland is informed and believes and on that basis alleges that said action is barred by California Corporations Code sections 31300 and 31301 in that plaintiffs knew the facts concerning the alleged untruths or omission; Southland further alleges that it exercised reasonable care and did not know, or if it had exercised reasonable care, it would not have known, of the alleged untruths or omissions.

FOURTH AFFIRMATIVE DEFENSE

(California Corporations Code Section 31302)

16. As a fourth, separate and affirmative defense to the alleged Second Cause of Action of the Complaint, Southland alleges that said action is barred by Section 31302 of the Corporations Code of the State of California.

FIFTH AFFIRMATIVE DEFENSE

(California Corporations Code Section 31303 and 31304)

17. As a fifth, separate and affirmative defense to the alleged Second Cause of Action of the Complaint, Southland alleges said cause of action is barred by the Statute of Limitations contained in Sections 31303 and 31304 of the Corporations Code of the State of California.

SIXTH AFFIRMATIVE DEFENSE

(Exemption from California Franchise Law)

18. As a sixth, separate and affirmative defense to the alleged First Cause of Action of the Complaint, Southland alleges that it is exempt from the provisions, regulations, and requirements of the Franchise Investment Law

and has fully complied with all requirements for exemption therefrom.

SEVENTH AFFIRMATIVE DEFENSE

(Not a Proper Class Action)

19. As a separate and Seventh Affirmative Defense to the alleged Second Cause of Action of the Complaint, Southland alleges:

a. The Second Cause of Action does not set forth facts sufficient to state the elements of a proper class action.

b. The questions of law and facts sought to be raised as to the purported class of persons which plaintiffs seek to represent are not of common and general interest to plaintiffs and to any one or more of said persons.

c. Such common questions of fact and law as may exist among plaintiffs and any one or more of said persons are not sufficiently important to the ultimate resolution of the asserted claims to permit their adjudication in a class action.

d. The purported class of persons which plaintiffs seek to represent herein is not an ascertainable class of plaintiffs within the meaning of Section 382, Code of Civil Procedure or Rule 23 Federal Rules of Civil Procedure and do not have a well-defined community of interest in the questions of law and fact sought to be raised herein.

e. Plaintiffs are not members of the purported class of persons which they seek to represent herein. Plaintiffs do not and cannot fairly represent the rights or protect the interests of the members of said purported class of persons which they seek to represent herein.

f. The interest of each of said purported class of persons is such as to assure the assertion of individual claims, thereby precluding any necessity for a class action in order to assure the assertion of such claims.

g. By reason of each and all of the foregoing, the within action is not a proper class action by plaintiffs.

EIGHTH AFFIRMATIVE DEFENSE

(Abatement By Virtue of Prior Pending Actions)

20. As a separate and Eighth Affirmative Defense to the alleged Second Cause of Action of the Complaint, Southland alleges:

a. Prior to or at the commencement of this action, persons whom plaintiffs purport to represent as class members filed in the Superior Court of the State of California, civil actions against Southland, entitled:

(1) *THOMAS L. SAMPSON AND WANDA LEE SAMPSON* vs. *THE SOUTHLAND CORPORATION, a corporation, et al.*, No. 505161-4;

(2) *PATRICK S. CHENG AND CATHY D. CHENG* vs. *THE SOUTHLAND CORPORATION, a corporation, GENE JANSSEN and CURTIS PARE, and DOES ONE THROUGH FIFTY*, No. 505162-3;

(3) *PHILLIP C. NEWELL AND JOAN R. NEWELL* vs. *THE SOUTHLAND CORPORATION, a corporation, FRED ELWOOD, JOSEPH GALEA, BARBARA GALEA, MICHAEL WILDMAN, and DOES ONE through FIFTY, inclusive*, No. 505164-1;

(4) *PAULINO GARZA AND MARIA J. GARZA* vs. *THE SOUTHLAND CORPORATION, a corporation, GENE JANSSEN, MICHAEL WILDMAN, MICHAEL DRURY, PHIL THOMPSON and DOES ONE through FIFTY, inclusive*, No. 505160-5;

(5) *EDWARD J. GOUVEIA AND BETTY GOUVEIA* vs. *THE SOUTHLAND CORPORATION, et al.*, No. 469216-2;

(6) *HARRY BATTERSBY* vs. *THE SOUTHLAND CORPORATION, a corporation, RAY D.*

BERRY; TERRY DeBARD; JOHN P. THOMPSON; JERE W. THOMPSON; WALTON GRAYSON III; JOSEPH S. HARDIN; R.G. SMITH; EUGENE PENDER; and DOES TEN THROUGH FIVE HUNDRED, inclusive, No. 390132;

(7) *MICHAEL M. COY AND GLORIA G. COY* vs. *THE SOUTHLAND CORPORATION, A Corporation; TAL COLSON; RAY D. BERRY; TERRY DeBARD; JOHN P. THOMPSON; JERE W. THOMPSON; WALTON GRAYSON III; JOSEPH S. HARDIN; R. G. SMITH; EUGENE PENDER; S. R. DOLE; and DOES ONE through FIVE HUNDRED, inclusive,* No. 506120-6; and

(8) *ARTHUR SCOVIS AND JENNY SCOVIS* vs. *THE SOUTHLAND CORPORATION, a corporation; JAY DEL GEORGIO; SAMUEL DI SPALTRO; MICHAEL CUTTER; RAY D. BERRY; TERRY DeBARD; JOHN P. THOMPSON; JERE W. THOMPSON; WALTON GRAYSON III; JOSEPH S. HARDIN; R. G. SMITH; EUGENE PENDER; S. R. DOLE; FRANK MEYERS; DOUGLAS PORTER; and DOES 1 through 50, inclusive,* No. C-235779.

b. These actions have been coordinated herein under the title "Market Franchise Cases." By said prior actions there plaintiffs, who are persons the plaintiffs in this action purport to represent as class members herein have alleged, *inter alia*, claims against Southland identical to claims raised in this action.

d. [*sic*] By reason of the foregoing, the commencement of this action by plaintiffs constitutes an improper splitting of an alleged single cause of action against defendant arising out of said agreements, and Southland is entitled to have this action abated as to those persons.

NINTH AFFIRMATIVE DEFENSE

(Failure to Seek Arbitration)

21. As a ninth, separate and affirmative defense to the alleged Second Cause of Action of the Complaint, Southland alleges:

(a) that the 7-Eleven Store Agreement entered into between plaintiffs and Southland provides, in part, that should a controversy or claim arise out of or relating to the Agreement, said controversy and/or claim shall be settled by arbitration in accordance with the Rules of the American Arbitration Association and that plaintiffs or Southland may file with the Association a demand for arbitration at any time;

(b) that plaintiffs contend, by their Complaint, that a controversy and claim arose, relating to said Agreement; and

(c) that plaintiffs have failed and refused to demand arbitration in accordance with the terms of said Agreement, and are accordingly barred from suit herein.

WHEREFORE, this answering defendant prays that:

1. Plaintiffs take nothing by their Complaint;

2. This answering defendant be awarded its costs of suit herein; and

3. The Court award such other and further relief as is just and proper in the premises.

DATED: June 8, 1978.

ARNOLD & PORTER
McKENNA & FITTING

By /s/ Charles G. Miller
Attorneys for Defendant
The Southland Corporation

[Verification and Proof of Service Omitted in Printing]

IN THE SUPREME COURT
OF THE UNITED STATES

THE SOUTHLAND CORPORATION, *et al.*,
Appellants,

v.

RICHARD D. KEATING, *et al.*,
Appellees.

ORDER

Filed January 10, 1983

Further consideration of the question of jurisdiction is postponed to the hearing of the case on the merits.

No. 82-500

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1982

THE SOUTHLAND CORPORATION, et al.,
Appellants,

vs.

RICHARD D. KEATING, et al.,
Appellees.

ON APPEAL FROM THE SUPREME COURT OF CALIFORNIA

MOTION TO DISMISS

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November 1982

BOWNE OF SAN FRANCISCO, INC. • 180 NINTH ST. • S.F., CA 94103 • (415) 864-8500

QUESTIONS PRESENTED

Pursuant to Rule 16 of this Court, the appellees move to dismiss the appeal now pending before this Court for the following reasons:

1. As to the class arbitration issue, none of the essential requisites to this Court's jurisdiction are present. The decision which Southland attempts to appeal from is not a final judgment on this issue. Nor was any federal question properly raised in the courts below. Even if those two jurisdictional prerequisites were present, no appeal would lie but only a petition for certiorari, which should be denied for lack of a substantial federal question.

2. The second issue likewise presents no substantial federal question. This issue is whether a California statutory scheme concerning arbitration is preempted by the Federal Arbitration Act (9 U.S.C. § 1 *et seq.*). The California statutory scheme contains both a modern arbitration statute (Cal. Code Civ. Proc. § 1280 *et seq.*) substantially identical to the federal act and an exception identical to and modeled after a federal exception to arbitration. The decision below is in accordance with other state and federal decisions. No substantial federal question is involved.

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No. 82-500

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1982

THE SOUTHLAND CORPORATION, et al.,
Appellants,

VS.

RICHARD D. KEATING, et al.,
Appellees.

ON APPEAL FROM THE SUPREME COURT OF CALIFORNIA

MOTION TO DISMISS

STATEMENT OF THE CASE

This case is before the Court solely on the basis of a California decision on the pleadings. Because of the undeveloped posture of the case, the allegations in the plaintiffs-appellees' ("plaintiffs") complaints were deemed true for purposes of decision by the California Supreme Court.

Those allegations are that the plaintiffs are either past or present franchisees of the convenience food stores commonly known as "7-Eleven" Stores. There are approximately 800 such franchise stores in the state of California. The Southland Corporation ("Southland") is the franchisor for each of these stores. In selling the franchises, Southland employs a standard form prospectus which purports to make the disclosures required by the California Franchise Investment Law[1] and a standard form of franchise agreement. After a franchise is sold, the operation of individual 7-Eleven stores is governed by a centralized bookkeeping system created and maintained by Southland.

The plaintiffs all entered into nearly identical franchise agreements with Southland. The lengthy printed contracts were offered on a take-it-or-leave-it basis and, as the California Supreme Court found, were adhesive in nature. Each of these contracts contained the same arbitration clause requiring that all disputes be subject to arbitration before the American Arbitration Association.

After becoming franchisees, the individual plaintiffs became convinced that Southland was guilty of various acts of wrongdoing. The eight coordinated lawsuits which are now before this Court were each filed at different times. The earliest action was filed by Edward and Betty Gouveia in the Superior Court for Santa Clara County in 1975; Thomas and Wanda Lee Sampson and Patrick and Cathy Cheng filed their separate actions in 1976; Phillip and Joan Newell filed their action in 1977. The case of *Garza v.*

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[1]California Corporations Code, sections 31500 et seq.

Southland, which was later dismissed pursuant to a settlement, was filed in Alameda County in 1976. In none of these actions did Southland move to compel arbitration. Thereafter, Richard D. and Darla Keating filed a class action in May 1977. A similar class action was filed by Harry M. Battersby in December 1977.

Because of the similarity of the individual and class actions, the California Judicial Council ordered that all the actions pending in superior courts of several counties be controlled by one state court as a coordinated proceeding. Other pending cases against Southland were coordinated before the same court. (*Coy v. Southland* and *Southland v. Scovis.*) As part of that coordinated proceeding, the plaintiffs amended their complaints to be more uniform.

In all the cases, the plaintiffs alleged that Southland violated the California Franchise Investment Law and sought declaratory relief establishing the invalidity of the arbitration clause. Except in the *Coy* and *Scovis* cases, which are limited to the statutory claims, the plaintiffs also alleged common law claims of breach of contract, breach of fiduciary duty, violation of the usury law and fraudulent and negligent misrepresentation.

The principal allegations of classwide misconduct are (1) that Southland systematically defrauded its franchisees by making inadequate or misleading disclosures in connection with the sale of franchises; (2) that it failed to provide accurate information on the expected overall performance of 7-Eleven stores; and (3) that it systematically charged the franchisees interest on invoices paid by the franchisor to suppliers for periods of time preceding actual payment.

For two years, when the only pending actions were those on behalf of a few scattered individuals, Southland did not move to arbitrate those cases even though in some of the actions it alleged arbitration as an affirmative defense. Instead, it took full advantage of the judicial process by cross-complaining in three of the actions and by engaging

in extensive discovery. For example, in *Gouveia,* the plaintiffs were deposed for five days. One of the plaintiffs in the *Garza* action was deposed for five days and the other for two days. Again, in the *Sampson* action, there was a three-day deposition of a witness. In *Cheng,* the named plaintiff's deposition was begun although not concluded. Only when the class action case of *Keating* was filed did Southland assert its right to arbitrate the issues in each of the pending actions. In Southland's view, the litigation did not really begin until the filing of *Keating,* the first class action. (Jurisdictional Statement ("J.S.") 3.)

Pursuant to Southland's motion to arbitrate, the actions were stayed in the trial court before class discovery had commenced and before a motion for certification could be made. The trial court ordered all common law issues arbitrated on an individual basis, refusing to entertain a prior motion for class certification. The plaintiffs sought a writ of mandate from the California Court of Appeal to reverse this part of the trial court's order. The order to arbitrate excluded any claims arising under the Franchise Investment Law which the trial court ruled were triable only in a judicial forum. Southland then appealed that ruling pursuant to the California arbitration statute (Cal. Code Civ. Proc. § 1294). By stipulation, the appeal and writ were consolidated for hearing before the California appellate courts.

The matters before the California Supreme Court were not the broad, sweeping issues which Southland portrays. Rather, as to the class claims, the issue was whether, under the narrow facts of the case, the competing policies underlying arbitration and class action, both of which are favored in California, may be reconciled in a manner which preserves the viability of each procedure. The court was fully aware that one solution was to hold that arbitration agreements contained in adhesion contracts may not operate to stay class actions otherwise properly maintainable in court. The court did not take this approach because, as it stated,

"the statutes and public policy supportive of arbitration require, however, that this result be avoided if means are available to give expression to the basic arbitration commitment of the parties." (J.S.App., 26a.) Instead, it approved the class arbitration as accommodating and preserving each procedure.

On the issue of whether the Franchise Investment Law claims were arbitrable, the court made a two-step analysis of the effect of Corporations Code section 31512. First, it determined that the California Legislature intended that the right of a franchise investor to a judicial forum could not be waived by an arbitration clause. The court then turned to the issue of preemption. Noting that California law and federal law are the same with respect to favoring arbitration, the court found that the Federal Arbitration Act was not intended to prevent or invalidate statutes, such as section 31512, based on a specific legislative policy to protect a particular class of litigants. (J.S.App. 17a-18a.)

SOUTHLAND HAS FAILED TO SHOW THAT THIS COURT HAS JURISDICTION

This case concerns a group of California franchisees affected by a preliminary decision of the state supreme court that its procedural law permits class arbitration of common law claims and that its Legislature was entitled to designate a judicial forum for statutory claims under the Franchise Investment Law. No substantial federal question is raised here. In today's world "Mom and Pop" grocery stores have in large part given way to franchises. The corner grocery—locally run and catering to local customers—is deemed to be involved in interstate commerce because it bears a federally registered trademark ("7-Eleven") and the franchisor with whom it has to deal is located in another state. Nonetheless, the franchisees' substantive claims in this litigation are governed entirely by the statutory and common law of the state of California where the franchises are operated.

To invoke this Court's jurisdiction, Southland must affirmatively demonstrate that it has met the threshold requirements of 28 U.S.C. § 1257. *Republic Natural Gas Co. v. Oklahoma,* 334 U.S. 62, 70-71 (1948). It has failed to do so. As to the issue of class arbitration it has not shown (1) that there is a final judgment; (2) that the federal law was drawn into question below; or (3) that a federal question is presented. As to the issue of whether the Federal Arbitration Act preempts state protective legislation paralleling federal protective legislation, the decision below is clearly correct, and presents no substantial federal question.

A. There Is No Appellate Jurisdiction on the Class Arbitration Issue

1. The question of whether the Federal Arbitration Act bars a class arbitration was not raised below

This Court has consistently refused to hear cases where the federal question is first raised by a party when seeking review in this tribunal. *Cardinale v. Louisiana,* 394 U.S. 437, 438 (1969). In fact, the Court is without "jurisdiction unless a federal question was raised and decided in the state court below." 394 U.S. at 438.

In its jurisdictional statement, Southland asks this Court to consider the question of whether "arbitration under the Federal Arbitration Act is unlawfully impaired" by an order requiring the trial court merely to consider whether class arbitration may be appropriate in this case. The thrust of Southland's argument is that because the Federal Arbitration Act establishes a strong federal policy in favor of arbitration, states cannot apply local procedures which might impair the federal policy.

Before the California Supreme Court, however, Southland did not argue that the federal act barred the class procedure. Rather, Southland contended that class arbitration was precluded by general policies in favor of arbitra-

tion, citing California precedent supposedly to that effect, and by the absence of *state* legislation authorizing a class action within the arbitration process. The California Supreme Court, was thus faced only with a conflict between *state* policies in favor of arbitration and *state* policies in favor of class actions. (J.S.App. 23a-30a.)[2] As the question now presented was neither raised nor decided below, Southland has not met this threshold jurisdictional requirement of 28 U.S.C. section 1257.

2. There is no final judgment before this Court on the issue of class arbitration

The California Supreme Court decision which Southland attempts to appeal is not a final judgment. As the court itself stated: "We assume, for purposes of this analysis, that *Keating* and *Battersby* would be maintainable as class actions under established principles, but we intimate no opinion as to whether that is, in fact, the case. That will be an issue for the trial court upon remand." (J.S.App.24a, n. 17.)

In *Cox Broadcasting Corp. v. Cohn*, 420 U.S. 469 (1975), this Court set forth four exceptions to the traditional final judgment rule, based on a practical application of that rule

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[2]Southland's petition to the California Supreme Court phrased the question as "[w]hether a court may enter an order compelling a private commercial arbitration governed by the Federal Arbitration Act and rules of the American Arbitration Association to proceed as a class action even though the terms of the parties' arbitration agreement do not provide for such a procedure." (South. Pet. for Hearing, p. 3.) Nevertheless, Southland did not argue below that the Federal Arbitration Act, as opposed to the California statute, barred the class action and, in fact, it relied on California authorities and discussed federal and foreign state law only for their persuasive value. As a consequence, both the majority and the dissent discussed this issue in terms of state law. The dissenting justices disagreed with the majority on the policy question and concluded that there was no contractual or California statutory basis for allowing class arbitration. (J.S. App. 37a-45a.)

to state court decisions which anticipate further proceedings in lower state courts. The only exception possibly relevant here is the fourth and last category directed to state decisions which "seriously erode" federal policy. In these instances, the federal issue has been finally decided, and reversal on the federal issue "will be preclusive of any further litigation on the relevant cause of action rather than merely controlling the nature and character of . . . the state proceedings still to come." 420 U.S. at 483. Review, however, may be granted only if, in addition, the state decision might "seriously erode" federal policy. 420 U.S. at 483.

The preliminary decision by the California Supreme Court that the trial court should consider whether there should be a class arbitration does not meet these criteria. First, a reversal by this Court would not "be preclusive of any further litigation on the cause of action" because the decision merely sanctions a procedure in the continuing litigation. Thus, it is expressly outside this exception.[3] Second, the exception is to be narrowly construed. The recent case of *Flynt v. Ohio,* 451 U.S. 619 (1981) noted that this exception must be limited to cases which seriously erode federal policy or else it would swallow the rule and every federal issue decided on a state interlocutory appeal would qualify for immediate review. Because the California decision concerns a matter of state court procedure, this criterion also is not met.

Accordingly, there can be no review at this time of the class action issue because of the lack of a final judgment.

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[3]In addition, although this Court's reversal would preclude further consideration of a class arbitration, such reversal would not eliminate the possibility of further, allegedly federal, issues arising, such as in connection with consolidation of individual arbitration proceedings. Southland asserts that the courts' authority to order consolidation is unsettled. (J.S. 19, n. 29.)

3. Assuming this Court would otherwise have jurisdiction, the class arbitration issue is properly one for certiorari rather than appeal

Southland erroneously contends that the class arbitration issue falls within this Court's appellate jurisdiction under 28 U.S.C. § 1257(2). (J.S. 2.) That section, however, authorizes an appeal only where a state statute was challenged below as repugnant to a federal law or the Constitution and found valid. Southland has not met this requirement.

In the case below, Southland did not challenge the validity of a state statute. Nor does it here. It does not frame the issue as a challenge to the validity of any particular state act which is "legislative in character," *Lathrop v. Donohue*, 367 U.S. 820, 824 (1961), but rather as a question of whether the lower court's decision theoretically impairs a federally protected right. (J.S. i.) When a party makes no challenge to the validity of a statute, but instead challenges a court's decision to take certain judicial action, an appeal does not lie and review can be premised only on this Court's discretionary jurisdiction. *Kulko v. California Superior Court*, 436 U.S. 84, 90 (1978). Thus, even if Southland had drawn the federal issue into question below and if there were a final judgment—and such have not been shown—Southland would at best be entitled to petition this Court for certiorari. *Addington v. Texas*, 441 U.S. 418, 422-423 (1979).

B. Southland Has Failed to Demonstrate That There Are Any Substantial Federal Issues

Both of the federal questions which Southland has attempted to frame are based on an overly broad reading of the Federal Arbitration Act. Thus, Southland argues that the California court's approval of the concept of class-wide arbitration as a matter of California procedural law will somehow impair the application of the Federal Arbitration Act in federal courts or other state courts. As to

the California Legislature's intention to require a judicial forum for resolution of claims under the Franchise Investment Law, Southland makes the sweeping assertion that "state-created 'exceptions' " would fly in the face of the Federal Arbitration Act and "violate the intent of Congress." (J.S. 28.) Southland is wrong on both counts. The California court's decision does not in any way undermine the Federal Arbitration Act or evince hostility toward arbitration as a means of dispute resolution.

California, like most states, has a modern arbitration act which it vigorously enforces.[4] It also applies the substantive provisions of the Federal Arbitration Act in cases involving interstate commerce. But the act does not govern the procedure to be followed by the state. The issue as to whether the arbitration can be handled on a class action basis is purely a question of state law. Thus, on this issue, the California Supreme Court undertook to reconcile potentially conflicting state policies favoring arbitration and favoring class actions. The court concluded that state policy favoring arbitration did not prevent use of the procedural device of a class action.

The court faced a different issue on the statutory claims. There, it had to reconcile the substantive provisions of the Federal Arbitration Act with the narrow exception to arbitrability embodied in the antiwaiver provision of California's Franchise Investment Law. The court concluded that the Federal Arbitration Act did not preclude the state legislature from specifying a judicial forum for enforcement of its Franchise Investment Law.

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[4]Since 1927, the California courts and Legislature "have 'consistently reflected a friendly policy toward the arbitration process.' That policy was expanded and clarified in the current arbitration statute which was adopted in 1961 and it continues to be the policy of this state." (J.S. App. 15a-16a (citations omitted).)

1. The Federal Arbitration Act does not displace local rules of procedure

The Federal Arbitration Act was intended to provide a procedure limited to the federal courts. Neither Congress nor this Court has ever determined that the scope of the Act should extend into the state courts so as to override their procedures, including class actions. Indeed, in the hearing before the California Supreme Court, Southland itself contended that under the *Erie* doctrine, the California District Court of Appeal had erred by applying the Federal Rules of Civil Procedure, Rules 81(a)(3) and 42(a), to a matter governed by California procedure.[5]

Prior to 1925, the federal courts, reflecting a traditional hostility toward arbitration agreements, generally refused to hold arbitration clauses specifically enforceable. *The Alanten,* 252 U.S. 313 (1920); *Hamilton v. Home Ins. Co.,* 137 U.S. 370 (1890). Even if the federal courts were inclined to enforce the clauses, there was no procedure by which they could do so. Cohen and Dayton, *The New Federal Arbitration Law,* 12 Va.L.Rev. 265, 275-276 (1926). The Federal Arbitration Act was drafted by the American Bar Association's Committee on Commerce, Trade and Commercial Law to remedy this situation. It was enacted by Congress in 1925 pursuant to its powers under the Commerce Clause, Admiralty and Article III of the Constitution.

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[5]As Southland stated, "[t]he Federal Rules of Civil Procedure are not applicable here. Under the *Erie* doctrine, state courts normally apply their own procedural rules in litigation involving a federal substantive right, provided such application does not impair the federal right. And under California law . . . there is no basis—statutory or otherwise—for compelling class arbitrations." (South. Pet. for Hearing, pp. 24-25.) Southland thus acknowledged that local procedure controlled and that the question was one of the state court reconciling state policies favoring both arbitration and class actions. See. pp 5-6, *supra.*

A chief author of the Act, Julius Cohen, wrote at the time,

> [T]he statute as drawn establishes a *procedure in the Federal courts* for the enforcement of certain arbitration agreements. It is *no infringement* upon the *right of each state* to decide for itself what contracts shall or shall not exist under its laws. . . . [W]hether or not an arbitration agreement is to be enforced is a question of the law of procedure and is determined by the law of the jurisdiction wherein the remedy is sought. Cohen & Dayton, *The New Federal Arbitration Law*, 12 Va.L.Rev., at 275-276 (italics supplied).

The drafting committee itself noted that the "statute providing for the enforcement of arbitration agreements does relate solely to *procedure of the Federal courts*. It is no infringement upon the right of each state to decide for itself what contract shall or shall not exist." Committee on Commerce, Trade and Commercial Law, *The United States Arbitration Act and Its Application*, 11 A.B.A.J. 153, 154-155 (1925) (italics supplied). "The bill declares that such agreements *shall be recognized and enforced by the Courts of the United States*." H.R. Rep. No. 96, 68th Cong., 1st Sess. 1 (1924) (italics supplied).

Indeed, this Court has deliberately declined to hold that the Act applies in any respect in the state courts. In *Prima Paint v. Flood & Conklin*, 388 U.S. 395 (1967), a diversity action involving the application of the interstate commerce clause, the Federal Arbitration Act was interpreted to require the arbitrator, not the federal district court, to decide a claim of fraud in the inducement, even in the face of a contrary state rule. The court in *Prima Paint* was asked to hold, based on the reasoning of *Robert Lawrence Co. v. Devonshire Fabrics*, 271 F.2d 402 (2d Cir. 1959), that the Federal Arbitration Act applies in state courts and that it is a national substantive law. The Court refused to do so stating, "the question is whether

Congress may prescribe how *federal courts* are to conduct themselves with respect to subject matter over which Congress plainly has power to legislate. The answer to that can only be in the affirmative." 388 U.S. at 405 (italics supplied).

The Second Circuit itself in *Robert Lawrence Company v. Devonshire Fabrics, Inc.*, 271 F.2d 402 (2d Cir. 1959), recognized that, "[t]o be sure much of the Act is purely procedural in character and is intended to be applicable only in the federal courts." 271 F.2d at 407. Hence, in *Main v. Merrill Lynch, Pierce, Fenner & Smith*, 67 Cal.App.3d 19 (1977), the court stated that the Federal Arbitration Act was applicable, yet had no difficulty with the fact that the detailed procedural provisions of the California statute, with respect to notice, hearings, etc., had been applied by the trial court. *See also, Vigo Steamship Corp. v. Marship Corp.*, 26 N.Y.2d 165, 309 N.Y.S.2d 165, *cert. denied*, 400 U.S. 819 (1970) (applying New York law to consolidate arbitration proceedings under Federal Arbitration Act).

By its exaggerated and unsupported interpretation of the scope of the Federal Arbitration Act, Southland seeks to transform issues of local California procedure into far-ranging federal ones. Class arbitration, however, is a procedural issue of concern in this case only to the California courts. It raises no question under the Federal Arbitration Act. A class action is a procedural device, ancillary to the litigation of substantive claims. *Vernon v. Drexel Burnham & Co.*, 52 Cal.App.3d 706, 716 (1975); *Deposit Guaranty National Bank v. Roper*, 445 U.S. 326, 336 (1980). Thus, so long as the forum court has authority based on its own law to employ the class action, there is no impediment to its so doing even when it is applying substantive law of another jurisdiction. *See, Kristiansen v. John Mullins & Sons, Inc.*, 59 F.R.D. 99, 108-110 (E.D.N.Y. 1973); *Briskin v. Glickman*, 267 F.Supp. 600 (S.D.N.Y. 1967).

Where, as here, the substantive claims are based solely on state law, the use of local procedure to enforce those claims is clearly a matter of state, and not federal, concern. California has consistently supported class actions where a widespread practice injures large numbers of people but "the amount of individual recovery would be insufficient to justify bringing an individual action." *Vasquez v. Superior Court*, 4 Cal.3d 800, 808 (1971).[6] It is particularly suited to the special circumstances arising where the contracts are uniform and the same provisions and practices apply to each member of the class. *LaSala v. American Sav. & Loan Assn.*, 5 Cal.3d 864, 877 (1971). The California Supreme Court rightly viewed the question before it as whether, in the context of an arbitration clause contained in an adhesion contract, it had inherent authority to reconcile the competing state policies favoring both arbitration and class actions. It concluded that it did.[7] Thus, the issue was treated as solely one of state procedure, presenting no federal question.

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[6]These cases are of special importance to state courts since only those class actions where each individual claim exceeds $10,000 are within federal jurisdiction. *Zahn v. International Paper Company*, 414 U.S. 291 (1973). Moreover, since the Federal Arbitration Act does not provide an independent basis for jurisdiction, the court congestion issue raised by Southland is largely a matter of state court dockets.

[7]Southland argues at length that a class action and arbitration are (hypothetically) incompatible. (J.S. 11-15.) This argument is irrelevant here, the question having been determined by the California court as a matter of state law. Indeed, Southland's only direct authority rejecting a class arbitration, *Harris v. Shearson Hayden Stone, Inc.*, 82 A.D.2d 87, 441 N.Y.S.2d 70 (1981), *aff'd mem.*, 56 N.Y.2d 627, 450 N.Y.S.2d 482 (1982), likewise was decided on the basis of state law. The only two other state supreme courts to address this issue directly *approved* class arbitrations under their state laws. *Stevenson v. Com. of Pennsylvania, Dept. of Revenue*, 413 A.2d 667 (Pa. 1980); *Boynton v. Carswell*, 238 Ga. 417, 233 S.E.2d 185 (1977), *overruled on other grounds, Calloway v. Carswell*, 240 Ga. 579, 242 S.E.2d 103 (1978).

The court looked to the federal cases which allow consolidation merely as analogous, and not governing, authority. (J.S.App. 26a-27a.) It also looked to cases from other states which support consolidation of arbitration proceedings, even in the absence of express statutory authority. (J.S.App. at 27a.) It then concluded that the fact that California's arbitration statute contained express authority allowing consolidation did not mean the California Legislature intended to prevent the California courts from ordering class arbitration in an appropriate case. (J.S. App. 28a.)

As is apparent from the foregoing, the question before the California Supreme Court and its resolution of that question were solely a matter of state law. Southland presents no federal question for review by this Court.

2. The preemption issue does not present a substantial Federal question

When this case was before the California Supreme Court, preemption was only a back-up argument which Southland did not expect the court to reach. (Reply Brief to Answer to Petition for Hearing, p. 12.) In seeking to compel arbitration, Southland relied primarily on the California arbitration statute. Thus, it argued that the antiwaiver provision of the Franchise Investment Law did not bar arbitration:

> Title 9 of the California Code of Civil Procedure (§ 1280 *et seq.*) establishes a comprehensive arbitration statute, and Section 1281 of that Code declares that written arbitration agreements are "valid, enforceable and irrevocable, save upon such grounds as exist for the revocation of any contract." Arbitration under this statute is highly favored by the law, and the courts have repeatedly held that in cases of doubt, every intendment should be in favor of upholding the agreement to arbitrate. This policy applies to tort claims generally, and to fraud and misrepresentation

> claims in particular. If the California Legislature had intended to overrule this long-standing policy in the case of disputes between franchisors and franchisees, it could and would have done so directly. In the absence of a clear legislative directive, this Court should not overturn the well-established policy by implication. (Reply Brief to Answer to Petition for Hearing, pp. 6-7.)

Southland's argument that the legislature did not intend to bar arbitration was rejected. The Franchise Investment Law is a prepurchase disclosure law modeled after the 1933 Securities Act. (J.S.App. 10a) Section 31512 is virtually identical to section 14 of the Securities Act of 1933, 15 U.S.C. § 77n. The California Supreme Court concluded that the choice of such language evidenced a clear legislative intent that section 31512 be interpreted in accordance with the interpretation given section 14 in *Wilko*.[8] The court's conclusion was buttressed by the legislative history of a different franchise law, the Franchise Relations Act, which explicitly recognized that the earlier law was modeled after the federal securities law and did not permit arbitration. (J.S.App. 11a-13a.) The question whether the court properly interpreted the intent of the California Legislature is purely one of state law and beyond the scope of review by this Court. *Merrill Lynch, Pierce, Fenner &*

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[8]The California court applied its own long recognized principle that state statutes patterned after federal statutes were intended to have a like interpretation. (J.S.App. 11a.) California is not alone in interpreting language similar or identical to the antiwaiver provisions of section 14 of the Securities Act, 15 U.S.C. § 77n, as precluding arbitration. *See, e.g., State Ex. Rel. Geil v. Corcoran*, 623 S.W.2d 557 (Mo. App. 1981) (state securities law precludes enforcement of arbitration clause); *Sandefer v. Reynolds Securities Inc.*, 618 P.2d 690 (Colo. App. 1980) (same); *Kiehne v. Purdy*, ... Minn. ..., 309 N.W.2d 60 (1981) (same).

Smith v. Ware, 414 U.S. 117, 133 (1973), *General Trading Co. v. State Tax Comm.*, 322 U.S. 335, 337 (1944).[9]

After reaching this conclusion, the California court was faced with the issue of possible preemption by the Federal Arbitration Act. As discussed above, the application of the Federal Arbitration Act in state court has never been mandated by Congress or this Court. Nonethless, the California Supreme Court, as well as a majority of state courts which have considered the question, recognizes that "the statute contains certain principles of 'substantive federal law' which must be applied regardless of forum, where federal jurisdiction exists." (J.S. App. 14a.)[10]

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[9]Southland makes much of the fact that the State of Washington in *Allison v. Medicab International, Inc.*, 92 Wash.2d 199, 597 P.2d 380 (1979), has interpreted its own franchise investment law differently, but that is of no import in determining the intent of the California Legislature. Indeed, in *Allison* the Washington court appears to have mistakenly discussed *Wilko* in terms of its impact on preemption, not as an aid in interpreting the intent of the Washington Legislature in passing that state's franchising statutes. 92 Wash. 2d at . . , 597 P.2d at 382. In neither *Allison*, nor the case upon which it relied—*Pinkis v. Network Cinema Corporation*, 9 Wash. App. 337, 512 P.2d 751 (1973)—was there a discussion of the policies and purposes behind the federal arbitration law or the Washington franchising statutes.

[10]Indeed, in *Barron v. Tastee Freez Intern., Inc.*, 482 F.Supp. 1213 (E.D. Wisc. 1980) and *Bache Halsey Stuart Shields, Inc. v. Moebius*, 531 F.Supp. 75 (E.D. Wisc. 1982), two cases relied upon by Southland, the district courts assumed that the Federal Arbitration Act applied only to federal courts. Both courts stated that in adjudicating the enforceability of an arbitration clause in a diversity action, a federal court was not required to consider any contrary state policy and might well reach a different result than a state court faced with the same issue. 482 F.Supp. at 1217, 531 F.Supp. at 77. *But see Muh v. Newburger, Loeb & Co.*, 540 F.2d 970 (9th Cir. 1976), where the court assumed that the state exception applied with equal force in federal court.

The California Supreme Court thus determined that the franchise agreements were within the broad reach of the Commerce Clause and therefore governed by the substantive provisions of the Federal Arbitration Act. Contrary to Southland's position, this does not end any inquiry as to the enforceability of the instant arbitration clauses. It begins the inquiry.

The first question is the scope of the Federal Arbitration Act under federal law. This Court itself has noted that "categories of contracts otherwise within the Arbitration Act but in which one of the parties characteristically has little bargaining power are expressly excluded [under 9 U.S.C. § 1] from the reach of the Act." *Prima Paint Corp. v. Flood & Conklin*, 388 U.S. 395, 402 n. 9 (1967). This Court has also recognized the inapplicability of the Federal Arbitration Act to other categories of disputes where the congressional schemes require judicial supervision to protect individuals from falling victim to the other party's superior bargaining power. *Wilko v. Swan*, 346 U.S. 427 (1953). Similarly, the circuit courts have held that claims under the Securities Exchange Act of 1934,[11] and the federal antitrust and bankruptcy laws are not arbitrable because the nature of the statutory schemes and the vital public interest involved necessitate judicial scrutiny.[12]

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[11] *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974) is not authority to the contrary. It has been uniformly interpreted to create a narrow exception to *Wilko* due to overriding policy considerations in the area of international securities transactions negotiated between parties of relatively equal bargaining power. *Accord, Mansbach v. Prescott Ball & Turben*, 598 F.2d 1017 (6th Cir. 1979); *Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith*, 558 F.2d 831 (7th Cir. 1977); *Sibley v. Tandy Corp.*, 543 F.2d 540 (5th Cir. 1976); *Ayres v. Merrill Lynch, Pierce, Fenner & Smith*, 538 F.2d 532 (3d Cir. 1976).

[12] *See, e.g., Merrill Lynch, Pierce, Fenner & Smith v. Moore*, 590 F.2d 823 (10th Cir. 1978); *Allegaert v. Perot*, 548 F.2d 432 (2d Cir.), *cert. denied*, 432 U.S. 910 (1977); *American Safety Equipment Corp. v. J. P. Maguire & Co.*, 391 F.2d 821 (2d Cir. 1968);

In interpreting their own state statutory schemes, the state courts have followed the lead of the federal courts and carved exceptions to the enforceability of arbitration clauses when necessary to effectuate other vital state policies.[13] In most cases, no conflict exists between the modern state arbitration laws and the Federal Arbitration Act. When a question does arise regarding a possible conflict between the application of the Federal Arbitration Act and the state arbitration laws, state courts have engaged in a responsible weighing process which balances the state's interest in enforcing its policy against the federal policy.[14] Thus, in *R.J. Palmer Construction Co. v.*

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accord, A. & E. Plastik Pak Co. v. Monsanto Company, 396 F.2d 710 (9th Cir. 1968); *Lee v. Ply Gem Industries, Inc.*, 593 F.2d 1266 (D.C. Cir.), *cert. denied*, 441 U.S. 967 (1979); *Applied Digital Technology, Inc. v. Continental Casualty Co.*, 576 F.2d 116 (7th Cir. 1978). Until recently, courts had also interpreted the patent and trademark laws as requiring judicial enforcement—a practice which was consistent with prior law but which has now been superseded by congressional directive in enacting the patent and trademark appropriations bill for 1983-85 Pub. L. No. 97-247 (1982). Significantly, Congress has left untouched the judicial construction of its intent in the area of securities litigation, bankruptcy and antitrust.

[13]*See, e.g., Kiehne v. Purdy*, . . . Minn. . . , 309 N.W.2d 60 (1981) (state securities law claims not arbitrable), *Sandefer v. Reynolds Securities Inc.*, 618 P.2d 690 (Colo. App. 1980) (same); *United Nuclear Corp. v. General Atomic Co.*, 93 N.M. 105, 597 P.2d 290, *cert. denied*, 444 U.S. 911 (1979) (state antitrust law claim not arbitrable), *Aimcee Wholesale Corp., v. Tomar Products Inc.*, 21 N.Y.2d 621, 237 N.E.2d 223 (1968) (same); *Durst v. Abrash*, 22 A.D.2d 39, 253 N.Y.S.2d 351 (1964) (issue of whether transaction was disguised usurious loan not arbitrable).

[14]As of January 1, 1982, 42 states and the District of Columbia have adopted modern arbitration statutes, *i.e.*, statutes enforcing agreements to arbitrate existing controversies *and* those arising in the future. Twenty-five states and the District of Columbia have adopted the Uniform Arbitration Act although a number of them have modified the Act to exclude certain categories of disputes. Variations include statutory exclusions as to *employer-employee disputes, e.g.*, Tex. Rev. Civ. Stat. Ann. art. 224 (Vernon Supp.

Wichita Band Instrument Co., 7 Kan.App. 363, 642 P.2d 127 (1982), the state court held that its statutory policy against arbitration of any tort claim was outweighed by the federal policy in favor of arbitration.[15] In *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Melamed*, 405 So. 2d 790 (Fla. [Dist. Ct. App.] 1981), the state appellate court upheld a New York arbitration provision in a contract on the ground that the Federal Arbitration Act prevailed over a state statute generally outlawing out-of-state arbitration provisions.

Narrowly drawn categories of exemption from arbitration require closer analysis of the legislative intent and the preemption question. In *Allison v. Medicab International, Inc.*, 92 Wash.2d 199, 597 P.2d 380 (1979), cited by Southland, the court found insufficient evidence of a legislative intent to bar arbitration under Washington's franchising law. It used the possibility of preemption as a further reason to infer that the legislature did not intend to bar arbitration.[16] Southland mistakenly relies on this decision

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1981); *torts, e.g.*, Ark. Stat. Ann. § 34-511 (Bobbs-Merrill Supp. 1981); *uninsured motorists, doctors* and *lawyers, e.g.*, S.C. Code § 15-48-10 (Lawyer Co-op Supp. 1981); and *contracts of adhesion, e.g.*, Iowa Code Ann. § 697A.1 (West Supp. 1982).

[15]Southland's hypothesis (J.S. 26) that if franchisor-franchisee disputes are not arbitrable under California law, the arbitration of interstate tort claims would soon be banned, is erroneous. As Southland is aware, California law is consistent with federal law in considering tort claims arbitrable. Kansas appears to be the only state to face the issue posed by Southland and has given overriding force to the Federal Arbitration Act.

[16]In *Middle East Transcontinental, Inc. v. Onion Crock, Inc.*, 144 Mich.App. 57, 318 N.W.2d 604 (1982), the court likewise found no legislative intent to reserve franchise claims for the judicial forum and did not reach the issue of preemption. In attempting to analyze the *Wilko* decision, the court relied on the wider choice of venue in federal court as the governing rationale. Southland does likewise. (J.S. 22 n. 34.) The *Wilko* decision, however, is not so limited. *See* discussion in *Wilko v. Swan*, 346 U.S. 427, 435-438 (1953); *see also Bernhardt v. Polygraphic Co.*, 350 U.S. 198, 202-203 (1956).

as evincing a belief that the Federal Arbitration Act is national substantive law preventing state law exceptions to arbitration. This is not true. Where a Washington appellate court did find a strong anti-arbitration policy in its Consumer Protection Act, the court proceeded to uphold such legislation in the face of a claim that it was preempted by the Federal Arbitration Act. *Wineland v. Marketex Intern. Inc.*, 28 Wash.App. 830, 627 P.2d 967 (1981).

> Considering the purpose of the Consumer Protection Act, its close similarity to the federal antitrust laws, and the clear exception to the operation of the arbitration act covering antitrust laws, we conclude that the policy of the arbitration act favoring arbitration should give way to the stronger policy behind the Consumer Protection Act. 28 Wash.App. at ....., 627 P.2d at 970, distinguishing *Allison v. Medicab International, Inc.*, 92 Wash.2d 199, 597 P.2d 380.

The Missouri Court of Appeals has likewise refused to order arbitration requested under both federal and state arbitration acts where violations of state securities law were alleged because of Missouri's "very strong policy in favor of providing a judicial forum for the claims of investors under the blue sky laws." *State Ex. Rel. Geil v. Corcoran*, 623 S.W.2d 557, 559 (Mo.App. 1981).

The California Supreme Court undertook a similar balancing test in reaching its conclusion that the Franchise Investment Law was not preempted by the Federal Arbitration Act. A close analysis of the preemption issue demonstrates the correctness of the court's decision.

"[W]hen a State's exercise of police power is challenged under the Supremacy Clause, '[this court] start[s] with the assumption that the historic police powers of the States [are] not to be superseded by [federal statutes] unless that was the *clear and manifest* purpose of Con-

gress.' [Citations.]" *Ray v. Atlantic Richfield Co.*, 435 U.S. 151, 157 (1978) (italics supplied).

As this Court has noted in an analogous context:

> "[F]ederal regulation of a field of commerce should not be deemed preemptive of state regulatory power in the absence of persuasive reasons—either that the nature of the regulated subject matter permits no other conclusion, or that the Congress has unmistakably so ordained." . . . [B]ecause "each case turns on the peculiarities and special features of the federal regulatory scheme in question," it is where there is in existence a pervasive and comprehensive scheme of federal regulation that pre-emption follows. *Merrill Lynch, Pierce, Fenner & Smith v. Ware*, 414 U.S. 117, 139 (1973.)

See also, Fidelity Federal Savings & Loan Assn. v. de la Cuesta, ... U.S. ....., 102 S.Ct. 3014 (1982).

In *American Airlines, Inc. v. Louisville & Jefferson C.A.B.*, 269 F.2d 811 (6th Cir. 1959), the Sixth Circuit analyzed the precise preemption issue involved here in holding that the district court properly looked to the law of Kentucky in finding that it was beyond the authority of the Air Board to enter into an arbitration agreement. The court succinctly stated the issue as follows:

> Federal power to pre-empt being clear, it remains to inquire just how much of the field the Congress intended to and did occupy [citation omitted]. Section 2 of the Federal arbitration statute, as qualified by § 1, determines the particular controversies to which §§ 3 and 4 of the statute may be applicable. [Citations.]
>
> • • •
>
> While the language [of § 2] might plausibly be read to support a broader construction, consideration of the Legislative history reveals that what the Congress intended was merely to overrule by legislation long-standing judicial precedent, which declared agree-

> ments to submit judicable controversies to arbitration contrary to public policy, on the ground that enforcement of such agreement would oust the courts of their jurisdiction . . . .
>
> [T]he Federal arbitration statute was intended to declare no more than the agreements to arbitrate "involving commerce," [9 U.S.C. §§ 1 and 2] previously held invalid or revocable or unenforceable for policy reasons apposite to arbitration in particular, such as ousting the courts of jurisdiction, are by virtue of the [Act] valid and enforceable, unless by other Federal law or State law such agreements are for other reasons to be held invalid or revocable or unenforceable. *American Airlines, Inc. v. Louisville & Jefferson C.A.B.*, 269 F.2d 811, 816 (6th Cir. 1959)[17]

The California court correctly recognized that the Federal Arbitration Act does not supplant all state law regarding the enforcement of arbitration clauses. It then analyzed the policies advanced by Corporations Code section 31512 to determine whether they were irreconcilable with the federal law. For this purpose, the California court looked to this Court's opinion in *Merrill Lynch, Pierce, Fenner & Smith v. Ware*, 414 U.S. 117 (1973). In *Ware*, a class action for collection of trust fund benefits, this Court considered an alleged conflict between arbitration mandated by the New York Stock Exchange rules adopted under the self-governing provisions of section 6 of the Securities Exchange Act, 15 U.S.C. § 78f, and California Labor Code section 229 (invalidating any private agreement to arbitrate a wage dispute). The unanimous opinion concluded that the exchange rules did not preempt the state Labor

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[17]*See also Duplan Corp. etc. v. W.B. Davis Hosiery Mills*, 442 F.Supp. 86 (S.D.N.Y. 1977) and *Supak & Sons Mfg. Co. v. Pervel Industries, Inc.*, 593 F.2d 135 (4th Cir. 1979), which both concluded that state laws incorporating U.C.C. § 2-207(2)(b) were not preempted by the Federal Arbitration Act.

Code because California "manifested a strong policy of protecting its wage earners from what it regards as undesirable economic pressures affecting the employment relationship." 414 U.S. at 140 (Stewart, J., not participating).

In its brief, Merrill Lynch relied on *Robert Lawrence,* discussed *supra* at p. 11, in arguing that the Federal Arbitration Act applied to its dispute with the alleged class represented by Ware. Nonetheless, the effect of the Federal Arbitration Act was not discussed in the *Ware* opinion. Southland asserts that a likely reason is that *Ware* involved a contract of employment exempted from arbitration under section 1 of the Act. (J.S. 25 n. 35.) Although that argument was made to the *Ware* court, it had no support in the case law. Federal courts facing the issue had long since held that account executives, such as Ware, were not "employees" within the meaning of section 1; and that the exception was limited to employees engaged in the *actual* movement of interstate goods. *Dickstein v. DuPont,* 443 F.2d 783, 785 (1st Cir. 1971); *Tenney Engineering, Inc. v. United Electrical Radio & Machine Workers,* 207 F.2d 450, 452-453 (3d Cir. 1953). It is doubtful that the *Ware* court would have overruled such cases *sub silentio,* and it has never been so interpreted. *See, e.g., Stokes v. Merrill Lynch, Pierce, Fenner & Smith,* 523 F.2d 433, 436 (6th Cir. 1975). Rather, the federal courts continue to include account executives within the ambit of the Federal Arbitration Act. 523 F.2d at 436; *Muh v. Newburger, Loeb & Co.,* 540 F.2d 970 (9th Cir. 1976).

Thus, Southland's attempt to distinguish *Ware* from the case at bar is in error. Subsequent case law suggests two other explanations for the *Ware* opinion's silence as to the impact of the Federal Arbitration Act—as an indication that the Act did not apply in state court[18] or that appli-

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[18] *See Stokes v. Merrill Lynch, Pierce, Fenner & Smith,* 523 F.2d 433, 436 (6th Cir. 1975).

cation of the Federal Arbitration Act does not affect the preemption analysis.[19] The California Supreme Court's decision reflects the latter view.

The *Ware* court gave effect to California's strong concern for the protection of wage earners. In the case at bar, California has manifested another strong concern: the protection of investors in franchise operations from misrepresentations by franchisors. California has determined that franchise investors, as a class, are in need of the same protection as that provided by Congress to investors in securities markets "requir[ing] the exercise of judicial direction to fairly assure [the] effectiveness" of the legislation. *Wilko v. Swan, supra,* 346 U.S. 427 at 437.

In this situation, as in *Ware,* there is no persuasive reason why the federal policy favoring arbitration should be deemed to preempt section 31512. The interpretation of the Act urged by Southland in this case will leave states powerless to enforce laws modeled after the federal antitrust and securities laws whenever arbitration clauses are inserted by the party with superior bargaining power.[20] The Federal Arbitration Act does not apply to similar federal claims. It would be anomalous indeed if it were interpreted absolutely to prohibit parallel state legislation:

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[19]*See Muh v. Newburger, Loeb & Co.,* 540 F.2d 970, 973 (9th Cir. 1976), where the court assumed the *Ware* preemption analysis applied in a similar case governed by the Federal Arbitration Act, but ruled that Labor Code section 229 was unavailable as a bar because the plaintiff did not have a true wage claim.

[20]Southland's argument that the state laws could still validly bar arbitration in intrastate disputes is practically meaningless. The broad scope presently given the commerce clause, together with the reality of today's business operations renders almost all entrepreneurs participants in interstate commerce. The "Mom and Pop" grocers who comprise the plaintiffs in this action are but one example. It is hard to imagine any franchise subject to the California Franchise Investment Law that would not have some involvement in interstate commerce.

"When respective federal and state sovereignties are juxtaposed, 'the proper approach is to reconcile "the operation of both statutory schemes with one another rather than holding one completely ousted."'" *Merrill Lynch, Pierce, Fenner & Smith v. Ware*, 414 U.S. 117, 127 (1973). Since the California statutory scheme is compatible with the federal scheme, this case presents no question for review before this Court.

CONCLUSION

The procedural history of this case, and in fact many of the arguments advanced before this Court, demonstrate that Southland's true intent is not to preserve the asserted inviolability of arbitration but to escape responsibility for its acts. In seeking arbitration, Southland relied on the parallel provisions of the California arbitration statute and the Federal Arbitration Act. It considered the California statute to govern both the procedural issue of class arbitration and the Franchise Investment Law claim. It relied on the federal act only as a back-up on the latter issue. Not until after the California Supreme Court ruled that Southland could not thwart a class by mere invocation of its arbitration clause did Southland abandon its reliance on the California statute.

Southland's posturing notwithstanding, there are no substantial federal questions here. The California Supreme Court's determination as to how this action should proceed is a matter of state concern presenting no issue for review by this Court. Accordingly, appellees respectfully submit that Southland's appeal be dismissed and its alternative petition for certiorari be denied.

Respectfully submitted,

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No. 82-500

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

THE SOUTHLAND CORPORATION, *et al.*,
Appellants,

v.

RICHARD D. KEATING, *et al.*,
Appellees.

On Appeal from the Supreme Court of California

APPELLANTS' OPPOSITION TO MOTION TO DISMISS

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APPELLANTS' OPPOSITION TO MOTION TO DISMISS

Appellants The Southland Corporation, *et al.* ("Southland") oppose appellees' Motion to Dismiss for the reasons set forth below.

A. The Court Has Jurisdiction Over This Case

1. *The Class Arbitration Issue Was Raised and Litigated in the Court Below*

Appellees argue that Southland failed to raise in the court below the question whether arbitration under the Federal Arbitration Act would be unlawfully impaired by judicially imposed class action procedures. (Motion to Dismiss at 5-6.) Appellees' contention is without merit.

In Southland's petition for hearing in the California Supreme Court, it framed the issue as "[w]hether a court may enter an order compelling a private commercial arbitration governed by the Federal Arbitration Act and the rules of the American Arbitration Association to

proceed as a class action . . . ." (Pet. for Hearing at 2.) In the body of its brief, Southland then argued: that "[u]nder both federal and California law" (*id.* at 6) arbitration is highly favored; that arbitration is intended to operate outside the judicial system; that a class action arbitration would require intimate judicial involvement; and that class action procedures would effectively eliminate the benefits of arbitration as a quick, inexpensive, informal alternative to judicial proceedings. Southland further argued that a class action arbitration would deny absent class members due process of law in violation of the U.S. Constitution unless courts closely supervised the arbitrator's conduct at every stage of the litigation. (*Id.* at 10-22.) Approximately sixty federal court decisions were cited in Southland's brief in support of these propositions.

It is of no moment that Southland additionally relied upon *state* court decisions from California and elsewhere. Quite plainly, the goals and procedures of arbitration would be equally affected by class action procedures regardless of whether a state arbitration statute, as opposed to the Federal Arbitration Act, were applicable. Moreover, since Southland and the appellee-franchisees had already *agreed* in the lower courts that the Federal Arbitration Act governed this case, it was unnecessary for Southland to argue at length that the policies of the federal statute—as opposed to the state arbitration law—would be affected by a class action.[1] Precedents from

[1] In the California Court of Appeal, the franchisee-plaintiffs noted that they "have not challenged Southland's contention that . . . the Federal Arbitration Act is applicable." (Petitioners' Supp. Mem. in re Arbitration in a Class Action, July 10, 1979, at 7.) The Court of Appeal accordingly had no difficulty in concluding that the federal act governed the case. (J.S. App. at 52a-53a.) Thus, in Southland's petition for hearing to the California Supreme Court, it was only necessary to note briefly that "[t]he instant cases are governed by the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.*, since the dispute involves interstate commerce." (Pet. for Hearing at 6 n.6.)

both federal and state courts were thus germane to the issues presented before the California court.[2] Likewise, the California Supreme Court found no need to dwell upon this point in its decision: It simply noted that the Federal Arbitration Act was applicable and was to be taken into account (J.S. App. 4a-5a), and then proceeded to address the questions whether such an arbitration would be unduly impaired by class action procedures and whether a class action in this context would deny class members due process of law.

2. *28 U.S.C. § 1257(2) Is Satisfied*

Appellees contend that one of the two issues raised by Southland's Jurisdictional Statement (the class arbitration question) must be reviewed under this Court's certiorari jurisdiction, rather than by appeal under 28 U.S.C. § 1257(2). (Motion to Dismiss at 8.) This argument ignores the rule that once the Court has appellate jurisdiction over one issue, it "also take[s] jurisdiction over any aspects of the case which would otherwise fall solely within [its] certiorari jurisdiction." *Cox Broadcasting Corp.* v. *Cohn*, 420 U.S. 469, 487 n.14 (1975). Since § 1257(2) clearly applies to at least one of the issues presented here (*i.e.*, the question whether the anti-arbitration policy in the California Franchise Investment Law is pre-

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[2] Appellees recognized in the courts below that it was appropriate to rely upon state court decisions even though the class arbitration issue arose under the Federal Arbitration Act. For example, in one of their briefs they stated:

> We are willing to accept the proposition that if there were a conflict between federal and state law, the federal law would control. Actually, we have been unable to discover any substantive difference between the federal act and the California statute, at least none that has any bearing on this case.

(Petitioners' Supp. Mem. in re Arbitration in a Class Action, July 10, 1979, at 7.)

empted by the Federal Arbitration Act), the Court has appellate jurisdiction over the entire case.[3]

3. *The Decision of the California Supreme Court Is an Appealable Final Judgment or Decree*

Appellees are incorrect when they assert that the California Supreme Court's decision on the class arbitration issue is not an appealable final judgment or decree. It is true, of course, that the dispute between the parties has not been finally resolved. However, the California court's decree clearly falls within a well-recognized category of cases in which this Court treats a decision as a final judgment even though additional proceedings are anticipated in the state courts. The case at bar is within the fourth category of appealable final judgments set forth in *Cox Broadcasting Corp.* v. *Cohn*, 420 U.S. at 482-83, namely, situations where (i) the federal issue has been finally decided in the state courts, (ii) reversal of the state court decision would be preclusive of further litigation on the relevant cause of action rather than merely controlling the nature of the state proceedings, and (iii) refusal to review immediately the state court decision might seriously erode federal policy.

First, the California Supreme Court has finally and conclusively upheld a state law restricting arbitration and has also ruled that judicial class action procedures are available in the arbitration context. Therefore, unlike the situation in *Flynt* v. *Ohio*, 451 U.S. 619, 621 (1981),

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[3] Moreover, § 1257(2) is independently satisfied with respect to the class arbitration issue. Although the class arbitration issue does not involve a state "statute," it does challenge California's class action rules. When, as here, court rules have a substantive, adverse impact on a federal substantive right, this Court has jurisdiction under § 1257(2). *Cf. In re Griffiths*, 413 U.S. 717 (1973); *Mayer* v. *City of Chicago*, 404 U.S. 189 (1971). In any event, the substantial issues presented in Southland's Jurisdictional Statement warrant review under the Court's certiorari jurisdiction. *See* 28 U.S.C. § 2103 (1976).

no other federal issues remain to be resolved and there is "no probability of piecemeal review with respect to federal issues."

Second, reversal by this Court would preclude further judicial litigation of the parties' dispute. Southland and the franchisee-complainants would quickly proceed to arbitration and the court proceedings would be at an end, as there would be no need for judicial supervision of any class action proceedings.

Third, a refusal to review immediately the California Supreme Court's decision "might seriously erode federal policy." *Cox Broadcasting Corp.* v. *Cohn*, 420 U.S. at 483. Appellees suggest in their Motion to Dismiss that no impairment of federal rights will occur unless the trial court ultimately certifies this case as a class action. (Motion to Dismiss at 6-7.) This misses the point. The decision of the court below permits a party to an arbitration agreement to file a judicial action, thereby invoking the formalities, procedures and delays inherent in court proceedings. It authorizes, at the very least, the filing of complaints, answers, motions of various kinds, discovery on the class action issue, briefing to the court, and a judicial decision on the class issue—a process that would consume many months. Thus, regardless of whether the court eventually certified the case as a class action at the end of this process, the parties would have been forced to run the gauntlet of expensive and time-consuming procedures in direct contradiction to "the unmistakably clear congressional purpose [in the Federal Arbitration Act] that the arbitration procedure, when selected by the parties to a contract, be speedy and not subject to delay and obstruction in the courts." *Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404 (1967). Moreover, as in *Cox*, even if Southland prevails in the further proceedings, "there would remain in effect the unreviewed decision of the State Supreme Court" that class action arbitrations may go forward despite the Federal Arbitration Act and due process considerations. 420 U.S. at 485.

Thus, the resolution of the questions now before the Court cannot "await final judgment without any adverse effect on important federal interests." *Flynt* v. *Ohio*, 451 U.S. at 622.

This case is also similar to the situation faced by the Court in *Mercantile National Bank* v. *Langdeau*, 371 U.S. 555 (1963), in which it reviewed an order that concerned the appropriate forum for further proceedings. As in *Langdeau*, it would serve "the policy underlying the requirement of finality in 28 U.S.C. § 1257 to determine now in which [forum] appellants may [proceed] rather than to subject them . . . to long and complex litigation which may be for naught if consideration of the preliminary question . . . is postponed until the conclusion of the proceedings." *Id.* at 558.[4]

Applying the "pragmatic approach" by which this Court determines finality for purposes of review,[5] it is clear that the judgment of the California Supreme Court is presently appealable to this Court.

B. The Questions Are Substantial

1. *State Courts Are Not Free to Encumber Private, Interstate Arbitrations with Judicial Class Action Procedures*

Appellees argue in their Motion to Dismiss that the Federal Arbitration Act is not applicable "in any respect" when proceedings relating to arbitration are filed in a

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[4] The present case is also similar in this respect to *Cohen* v. *Beneficial Industrial Loan Corp.*, 337 U.S. 541, 546 (1949), in which the Court reviewed a collateral order regarding an issue which was separable from, and independent of, the merits and where, if review were postponed until the end of the litigation, it would be "too late effectively to review the present order, and the rights conferred by the statute . . . [would be] lost, probably irreparably." *Accord, Firestone Tire & Rubber Co.* v. *Risjord*, 449 U.S. 368, 376-77 (1981). *See also Cox Broadcasting Corp.* v. *Cohn*, 420 U.S. at 481-82 & n.10.

[5] *Cox Broadcasting Corp.* v. *Cohn*, 420 U.S. at 486-87, 478 n.7.

state court. (Motion to Dismiss at 10-14.) This position ignores the critical distinction between matters of substance and procedure.

The Federal Arbitration Act contains both substantive and procedural provisions. Section 2 of the statute, 9 U.S.C. § 2 (1976), creates a substantive federal right. It states that arbitration agreements in maritime and interstate contracts "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." The courts have almost universally held that this provision creates a substantive right that is equally enforceable in federal and state courts.[6]

In contrast, Sections 3-13 of the Federal Arbitration Act, 9 U.S.C. §§ 3-13, largely establish *procedural* rules to be followed in judicial actions for the enforcement of arbitration agreements. In contrast to Section 2, most of these provisions are, by their terms, applicable only to federal courts, so that when proceedings to enforce an arbitration agreement are brought in a state court, that court may apply its own procedural rules. (*See* authorities cited in appellees' Motion to Dismiss at 11-12.) This is simply an application of the general principle that states are free to apply their own court rules in cases arising under federal law, provided that such application does not impair the federal right.

The cases cited in appellees' Motion to Dismiss recognize the distinction between the substantive and procedural aspects of the Federal Arbitration Act. For example, in *Robert Lawrence Co.* v. *Devonshire Fabrics, Inc.*, 271 F.2d 402 (2d Cir. 1959), *cert. dismissed*, 364 U.S. 801 (1960), which appellees cite for the proposition that the Act only applies in federal courts (Motion to Dismiss at 12), the court of appeals stated:

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[6] *See, e.g., Merrill Lynch, Pierce, Fenner & Smith* v. *Haydu*, 675 F.2d 1169, 1173 (11th Cir. 1982). *See also* cases cited at J.S. App. 32a-37a.

> To be sure much of the Act is purely procedural in character and is intended to be applicable only in the federal courts. But Section 2 declaring that arbitration agreements affecting commerce or maritime affairs are "valid, irrevocable, and enforceable" goes beyond this point and must mean that arbitration agreements of this character, previously held by state law to be invalid, revocable or unenforceable are now made "valid, irrevocable, and enforceable." *This is a declaration of national law equally applicable in state or federal courts.*[7]

The decision of the California Supreme Court in the case at bar was not simply a procedural ruling governing the manner in which the trial court would conduct *its* proceedings relating to enforcement of the arbitration agreement. Rather, the decision seeks to govern the manner in which the arbitration itself will proceed and seeks to create an ongoing, intimate role for the judiciary in supervising any class action arbitration. For the reasons noted in the Jurisdictional Statement, the California court's ruling would have a serious, *substantive* impact on arbitration by converting a speedy, informal, inexpensive, nonjudicial mechanism into one that would be precisely the opposite.

This Court has previously rejected the contention that arbitration is a mere "procedural" device. In *Bernhardt* v. *Polygraphic Co. of America*, 350 U.S. 198, 202-05 (1956), the Court explicitly ruled that the procedures used in arbitration can affect the outcome of a case and are thus substantive in nature. Moreover, if this Court were

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[7] 271 F.2d at 407 (emphasis supplied). Chief Justice Burger was a member of the court of appeals' panel in *Lawrence*.

Appellees mistakenly suggest in their Motion to Dismiss that this Court held in *Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967), that the Federal Arbitration Act does not apply in state courts. (Motion to Dismiss at 11-12.) In fact, *Prima Paint* was a *federal* court case, and the Court did not even address the question whether the Act applies in state courts.

to accept appellees' contention that the Federal Arbitration Act is inapplicable in state courts, it would mean that a party's right to a meaningful arbitration under the Federal Arbitration Act would depend upon the forum in which proceedings were brought to enforce the arbitration agreement. In view of the fact that the Federal Arbitration Act was intended to create a uniform, national policy favoring quick and informal arbitration of disputes in interstate commerce, it is important for this Court to review and overturn the decision of the California Supreme Court.

2. *The California Legislature Cannot Create "Exceptions" to the Federal Arbitration Act*

Most of appellees' contentions concerning the power of the states to preempt the Federal Arbitration Act are addressed in the Jurisdictional Statement. However, we briefly note the following:

(a) This Court clearly has appellate jurisdiction to review the validity of the anti-arbitration policy of the California Franchise Investment Law as applied to interstate agreements. Appellees do not contend that 28 U.S.C. § 1257(2) is inapplicable to this issue and do not contend that the California Supreme Court's decision with respect to it is nonfinal.

(b) Appellees have not offered any principle to restrict the reach of their proposal to permit state legislatures to create "exceptions" to the Federal Arbitration Act. They only argue that individual state courts have in the past generally engaged in a "responsible" weighing process, balancing the policy of a local anti-arbitration statute against the contrary policy of the Federal Arbitration Act. (Motion to Dismiss at 18. *See also id.* at 14-25.) This provides no meaningful protection against erosion of the important federal policies embodied in the federal statute and, as in the present case, allows individual state courts to deprive persons of federally created and protected rights.

(c) Subsequent to the filing of Southland's Jurisdictional Statement, another court has rejected the proposition that a party can avoid arbitration by suing under a state regulatory statute. In *Klein Sleep Products, Inc.* v. *Hillside Bedding Co.*, BUS. FRANCH. GUIDE (CCH) ¶ 7886 (S.D.N.Y. 1982), plaintiff sued under the New York Franchise Sales Act and argued that claims under that law were nonarbitrable. The court held that since the case involved an interstate contract, it was obligated to enforce the arbitration agreement "regardless of state regulatory policies." *Id.* at p. 13,336.

For the foregoing reasons, appellants The Southland Corporation, *et al.*, respectfully request that appellees' Motion to Dismiss be denied.

Respectfully submitted,

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No. 82-500

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

THE SOUTHLAND CORPORATION, *et al.*,
Appellants,

v.

RICHARD D. KEATING, *et al.*,
Appellees.

On Appeal from the Supreme Court of California

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March 1983

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

QUESTIONS PRESENTED

1. Whether a state statute violates the Supremacy Clause of the United States Constitution when it invalidates arbitration agreements involving interstate commerce that are "valid, irrevocable, and enforceable" under the terms of the Federal Arbitration Act.

2. Whether the federally protected right of arbitration under the Federal Arbitration Act is unlawfully impaired when a state court superimposes judicial class action procedures (including court-supervised discovery, briefing, certification, notice and opt-out procedures, mandatory preparation of transcripts, and ongoing judicial control) on a private arbitration of a commercial dispute involving interstate commerce.

PARTIES BELOW

This appeal involves eight cases that were consolidated in the court below.* Plaintiffs, who are former franchised operators of 7-Eleven® convenience stores in the State of California, are Richard and Darla Keating, Edward and Betty Gouveia, Harry Battersby, Patrick and Cathy Cheng, Michael and Gloria Coy, Phillip and Joan Newell, Thomas and Wanda Sampson, and Arthur and Jenny Scovis. Some of the plaintiffs purport to represent a class consisting of all current and former 7-Eleven franchisees in California.

Defendants are The Southland Corporation, which owns the 7-Eleven® service mark, and several of its current and former officers, directors and employees: John P. Thompson, Jere W. Thompson, Walton Grayson, III, Joseph S. Hardin, R. G. Smith, Eugene Pender, S. R. Dole, Terry De Bard, Gene Janssen, Curtis Pare, Ray Berry, Paul Stevenson, Michael Wildman, Robert Johnson, Ernest Arzabal, Michael Drury, Keith Jenkins, Robert Duncan, Fred Elwood, Joseph Galea, Dave Pava, Tal Colson and Douglas Porter.

Defendant The Southland Corporation has no parent corporation, subsidiaries (except wholly owned subsidiaries), or affiliates.

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* One additional case, *Garza* v. *Southland*, was originally consolidated with the others but has since been settled.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

No. 82-500

THE SOUTHLAND CORPORATION, *et al.*,
Appellants,

v.

RICHARD D. KEATING, *et al.*,
Appellees.

On Appeal from the Supreme Court of California

BRIEF OF APPELLANTS

Appellants, The Southland Corporation and several of its current and former officers, directors and employees (hereinafter collectively referred to as "Southland"), appeal from a decision of the Supreme Court of California.

OPINIONS BELOW

The majority and dissenting opinions of the California Supreme Court are reported at 31 Cal. 3d 584, 183 Cal. Rptr. 360, 645 P.2d 1192 (1982), and are reprinted in the separate Appendix to appellants' Jurisdictional Statement at 1a-45a (hereinafter "J.S. App."). The opinion of the California Court of Appeal, First District, is reported at 109 Cal. App. 3d 784, 167 Cal. Rptr. 481

(1980), and is reprinted at J.S. App. 47a-70a. The orders of the Superior Court of Alameda County (J.S. App. 71a-80a) are unreported.

JURISDICTION

The judgment of the Supreme Court of California was entered on June 10, 1982, and a timely notice of appeal was filed by Southland. (J.S. App. 83a-84a.) After receiving an extension of time to docket its appeal (J.S. App. 85a), Southland filed its Jurisdictional Statement on September 22, 1982 pursuant to 28 U.S.C. § 1257(2). On January 10, 1983 the Court ordered that "[f]urther consideration of the question of jurisdiction is postponed to the hearing of the case on the merits." 103 S. Ct. 721 (1983). (Joint Appendix at 36 [hereinafter "J.A."].) The grounds upon which this Court's jurisdiction is invoked are discussed in greater detail at pages 11-23, below.

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

The following constitutional and statutory provisions are involved in this appeal:

28 U.S.C. § 1257 (1976). State courts; appeal; certiorari

> Final judgments or decrees rendered by the highest court of a State in which a decision could be had, may be reviewed by the Supreme Court as follows:
>
> . . . .
>
> (2) By appeal, where is drawn in question the validity of a statute of any state on the ground of its being repugnant to the Constitution, treaties or laws of the United States, and the decision is in favor of its validity.

U.S. Const. art. VI, cl. 2 (the Supremacy Clause)

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; . . . shall be the supreme Law of the Land; and the

Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

Section 2 of the Federal Arbitration Act (9 U.S.C. § 2 (1976))

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

California Franchise Investment Law, Cal. Corp. Code § 31512 (West 1977)

Any condition, stipulation or provision purporting to bind any person acquiring any franchise to waive compliance with any provision of this law or any rule or order hereunder is void.

STATEMENT OF THE CASE

This appeal concerns a decision of the California Supreme Court, holding that the California legislature is free to carve out exceptions to the Federal Arbitration Act, 9 U.S.C. §§ 1-14 (1976). This appeal also challenges the California Supreme Court's decision that a party to an arbitration agreement governed by the Federal Arbitration Act is entitled to petition a court to direct his arbitration claim to proceed on a "class action" basis. The court rejected Southland's argument that the state statute and class action procedures are inconsistent with the goals and procedures of arbitration under the Federal Arbitration Act, and therefore are preempted by the federal law.

The litigation began in May 1977 with the filing of an action by Richard and Darla Keating in the Superior Court for Santa Clara County, California. Plaintiffs were franchised operators of a 7-Eleven® convenience store. They alleged that their franchisor, Southland, had utilized an accounting system in preparing financial statements for their store that was unfair and inaccurate, and that representatives of Southland had made certain fraudulent representations concerning the accounting system. Southland's conduct was alleged to give rise to several related causes of action, including common law fraud, breach of contract, breach of fiduciary duty, and a violation of the California Franchise Investment Law.[1] Plaintiffs purported to represent a class of all current and former 7-Eleven franchisees in California.[2] Thereafter, several other 7-Eleven franchisees who had previously filed lawsuits against Southland in various California state courts amended their complaints to conform to the allegations in *Keating*, and they successfully petitioned the state Judicial Council to coordinate all of the cases in one trial court.

Southland filed a motion to compel arbitration in *Keating* pursuant to an arbitration clause in the franchise agreement, which provided that the parties would arbitrate "any controversy or claim arising out of or relating

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[1] The California Franchise Investment Law requires franchisors to make certain disclosures to prospective franchisees, and prohibits franchisors from making fraudulent or misleading statements to those prospective franchisees. Cal. Corp. Code §§ 31000-31516 (West 1977 & 1982 Supp.). In essence, it establishes a specific statutory cause of action for certain fraudulent conduct. Plaintiffs' claim under this statute is based on the same facts as, and is largely duplicative of, plaintiffs' various common law causes of action.

[2] Plaintiffs' original complaint alleged a class consisting of all current and former 7-Eleven franchisees in the United States, but the scope of the purported class was narrowed to California franchisees in an amended complaint filed in January 1978. Plaintiffs alleged that there were in excess of 800 persons in this amended "class." (J.A. at 15.)

to this Agreement or the breach hereof . . . in accordance with the Rules of the American Arbitration Association . . . ." Southland promptly filed similar motions in the other consolidated cases after plaintiffs in those actions amended their pleadings to assert the complex accounting issues that had been raised in the *Keating* complaint.[3]

Plaintiffs in each case resisted arbitration on a variety of grounds. Among their contentions was that claims based on the California Franchise Investment Law are nonarbitrable by virtue of a statutory provision that renders void any contract clause requiring a franchisee to "waive" his rights under that law. Cal. Corp. Code § 31512 (West 1977) (reprinted *supra* at p. 3.) As a fallback position, plaintiffs suggested that if their claims were arbitrable, the court should create a procedure whereby the arbitration would be conducted as a class action.

The Superior Court held that plaintiffs were required to arbitrate their claims of common law fraud, breach of contract and breach of fiduciary duty, but not their claims under the Franchise Investment Law. (*See* J.S. App. 72a, 74a, 79a.)[4] The court did not reach the issue whether the arbitration should proceed as a class action.

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[3] The original pleadings in the cases filed prior to *Keating* had primarily alleged oral misrepresentations by various employees of Southland concerning the prospective sales, profitability, etc. of the plaintiffs' stores. The California Supreme Court noted that the amended complaints substantially changed the focus of plaintiffs' claims, and it rejected plaintiffs' contention that Southland had waived its right to demand arbitration in these cases. (J.S. App. 21a-22a.)

Plaintiffs in all of the coordinated cases were represented by the same attorneys. However, rather than joining in the purported class action in *Keating*, several of the plaintiffs chose to continue the prosecution of their own cases.

[4] The Superior Court's orders did not explain the reasons for denying arbitration of the Franchise Investment Law claims.

Southland appealed from the court's refusal to compel arbitration of the Franchise Investment Law claims. The franchisees, in turn, filed a petition for a writ of mandamus or prohibition in which they argued, *inter alia*, that the arbitration should proceed as a class action. (*See* J.S. App. 48a.)[5]

The California Court of Appeal rejected plaintiffs' argument that the Franchise Investment Law invalidates arbitration agreements. (J.S. App. 66a-68a.) It further concluded that if the statute were interpreted to contain such a provision, it would be invalid with respect to contracts involving interstate commerce because the Federal Arbitration Act provides that such arbitration agreements are "valid, irrevocable, and enforceable." (J.S. App. 68a-70a.) The court therefore held that the Franchise Investment Law claims were arbitrable along with the remainder of plaintiffs' causes of action. (J.S. App. 70a.) The Court of Appeals also ruled, however, that there was no "insurmountable obstacle" to conducting an arbitration on a classwide basis (J.S. App. 63a), and it

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However, the trial judge later explained on the record (i) that in his view, the arbitration clause in the 7-Eleven franchise agreement was not broad enough to include these claims, and (ii) that he therefore had not reached plaintiffs' argument that Franchise Investment Law claims were nonarbitrable. Transcript of Hearing of July 19, 1978, at 20-24, *Market Franchise Cases*, Cal. Jud. Council Coord. No. 387 (Cal. Super. Ct., Alameda Co.), *reprinted in* Reporter's Transcript on Appeal to California Court of Appeal 86, 105-09. The Superior Court's narrow construction of the contract was reversed by the California Court of Appeal (J.S. App. 65a-66a), and that ruling was not disturbed by the California Supreme Court.

[5] Under California law, a court's refusal to compel arbitration is treated as an appealable order, *see* Cal. Code Civ. Proc. § 1294(a) (West 1982), but an order compelling arbitration is nonappealable and is subject to immediate review only by a writ of prohibition or mandamus. *E.g., La Pietra* v. *Freed*, 87 Cal. App. 3d 1025, 1030-31, 151 Cal. Rptr. 554, 557 (1978).

issued a writ of mandate directing the trial court to conduct class certification proceedings. (J.S. App. 64a.)

The California Supreme Court, by a divided vote of 4-2, reversed the Court of Appeal's ruling that claims asserted under the California Franchise Investment Law are arbitrable. It concluded that the California legislature intended to render arbitration agreements unenforceable with respect to claims based on that statute, and it held further that anti-arbitration statutes of this kind do not contravene the federal substantive law embodied in the Federal Arbitration Act. (J.S. App. 8a-18a.)

The California Supreme Court, again by a 4-2 majority, affirmed the Court of Appeal's ruling on the availability of a class action arbitration procedure. (J.S. App. 23a-30a.) Although it acknowledged that the Federal Arbitration Act was applicable and controlling (J.S. App. 4a-5a), the court based its decision on a California public policy favoring class actions. Consequently, the court held that a class action arbitration could be imposed upon the parties without their mutual consent.

The majority did not directly address Southland's argument that a class action would be fundamentally inconsistent with arbitration, which is intended to be a simple, quick, inexpensive and nonjudicial procedure. The court acknowledged, however, that "[w]ithout doubt a judicially ordered classwide arbitration would entail a greater degree of judicial involvement than is normally associated with arbitration," including initial class certification and "a measure" of ongoing judicial supervision "in order to safeguard the rights of absent class members to adequate representation and in the event of dismissal or settlement." (J.S. App. 28a-29a.) The court contemplated that the trial court would authorize discovery and briefing on the class action issue; determine whether a class action was appropriate; supervise any notice and opt-out procedures; oversee the arbitration proceedings themselves to ensure that the interests of the class were being

adequately represented by the named claimants and adequately protected by the arbitrators; and review any dismissal or settlement. (*See* J.S. App. 29a.) The majority also acknowledged that the trial court would have to exercise "[a] good deal of care, and ingenuity" in order to supervise the arbitration proceedings in these ways while "avoid[ing] judicial intrusion upon the merits" and "minimiz[ing] complexity, costs, or delay." (J.S. App. 29a.)

The dissenting justices (Richardson and Mosk, J.J.) disagreed with the majority on both issues. (J.S. App. 30a-45a.) First, with respect to the California Franchise Investment Law question, they referred to the long line of authority establishing that the Federal Arbitration Act creates a body of federal substantive law that supersedes any state policies seeking to invalidate arbitration agreements involving interstate commerce. (J.S. App. 32a-34a.) They disagreed with the majority's view that the states are free to carve out exceptions to the federal statute. (J.S. App. 37a.) Second, the dissenting justices rejected the propriety of a class action arbitration, concluding that it would be "fundamentally contrary to the purpose of arbitration and to the public policy encouraging arbitration." (J.S. App. 44a.) They noted the absence of statutory or precedential authority for the procedure; catalogued ways in which courts inevitably would supervise, review and interfere with arbitrators' actions; and then concluded that the majority's newly-fashioned procedure "would tend to make arbitration inefficient instead of efficient, lengthy instead of expeditious, and procedural instead of informal." (J.S. App. 41a.)

SUMMARY OF ARGUMENT

I. The Court has jurisdiction over this case pursuant to 28 U.S.C. § 1257(2) because the decision of the California Supreme Court constitutes a "final judgment" regarding the validity of a state statute and procedures that were "drawn into question" in the court below.

A. Under the principles established by this Court in cases such as *Cohen* v. *Beneficial Industrial Loan Corp.*, 337 U.S. 541 (1949), and *Cox Broadcasting Corp.* v. *Cohn*, 420 U.S. 469 (1975), the decision of the court below is "final," notwithstanding the fact that the California court directed judicial proceedings to continue in the trial court, because the decision deals with issues that (i) have been finally adjudicated by the state court, (ii) are collateral to the merits, (iii) are novel and important, and (iv) cannot meaningfully be reviewed after the proposed judicial proceedings have run their course. Appellants' right to avoid the delays and costs of litigation in the courts must be determined now, or it will effectively be lost forever. Additional factors favoring prompt appellate review are the facts (v) that the decision of the California court would erode the strong public policy favoring arbitration under the Federal Arbitration Act, and (vi) that reversal by this Court of the California court's decision would terminate the court proceedings so that the parties could proceed immediately to resolve their disputes in a nonjudicial forum.

Furthermore, one of the two questions presented (the class action arbitration issue) was adjudicated in a separate proceeding brought by the appellees for a writ of mandamus or prohibition. The final disposition of that separate proceeding is an appealable final judgment.

B. The issues raised by this appeal were presented to, and were ruled upon, by the California Supreme Court. Appellees' claim that appellants failed to litigate one of the two issues (the class action issue) is erroneous.

II. Under the terms of the Federal Arbitration Act, agreements to arbitrate commercial disputes involving interstate commerce are "valid, irrevocable, and enforceable." 9 U.S.C. § 2. The Act provides that an interstate arbitration agreement can only be struck down on the

basis of general contract principles that apply to all contracts (*e.g.*, duress, lack of legal capacity). The Act creates "a body of federal substantive law of arbitrability" that favors arbitration agreements, "notwithstanding any state substantive or procedural policies to the contrary." *Moses H. Cone Memorial Hospital* v. *Mercury Construction Corp.*, 51 U.S.L.W. 4156, 4162 (U.S. Feb. 23, 1983). Thus, the Supremacy Clause of the United States Constitution preempts state statutes that purport to invalidate agreements that are made "valid, irrevocable, and enforceable" by the Federal Arbitration Act.

The California Franchise Investment Law attempts to block the enforcement of arbitration agreements. This anti-arbitration provision applies regardless of whether the arbitration agreement was willingly executed by persons having legal capacity, and regardless of whether the agreement provides for a fair and impartial resolution of the parties' dispute. The case at bar involves a contract in interstate commerce. Accordingly, under the Supremacy Clause, the California statute must give way to the strong federal policy favoring arbitration.

III. The California Supreme Court has improperly attempted to superimpose judicial class action procedures onto private arbitrations of commercial disputes under the Federal Arbitration Act. The mechanism created by the court below would be enormously complex, expensive and time-consuming, and would be conducted by a court from start to finish. The state court's unprecedented procedure is fundamentally at odds with the purposes and procedures of arbitration, which is intended to be simple, economical, quick and, most importantly, nonjudicial. Accordingly, as applied to interstate contracts, the decision of the California Supreme Court is an improper, destructive interference with a federally protected right, and should be invalidated by this Court.

ARGUMENT

I. THE COURT HAS JURISDICTION OVER THIS CASE

This Court has jurisdiction pursuant to 28 U.S.C. § 1257(2) (1976), which confers appellate jurisdiction over final judgments or decrees rendered by the highest court of a state where the validity of a state statute is drawn into question on the ground of its being repugnant to federal law and the state court has upheld the challenged statute. In the case at bar, Southland drew into question the validity of the California Franchise Investment Law and class action rules as applied to arbitration proceedings governed by the Federal Arbitration Act. The California Supreme Court's decision regarding these issues constitutes a "final judgment or decree" within the meaning of Section 1257(2).

A. The Decision of the California Supreme Court Constitutes a Reviewable Final Decision

1. *The Ruling on the Nonarbitrability of Claims Under the California Franchise Investment Law Is Final*

The highest court of California has held that arbitration agreements are unenforceable with respect to claims asserted under the state's Franchise Investment Law. This ruling is not subject to further review in the state courts, and it does not leave any discretion to the trial judge to honor Southland's demand for arbitration.

The California Supreme Court's ruling does not terminate the judicial proceedings. However, it is precisely this fact that will cause the injury for which Southland seeks redress in this appeal. Arbitration is intended to be speedy, economical and *nonjudicial*; and the Federal Arbitration Act calls for "mov[ing] the parties to an arbitrable dispute out of court and into arbitration as quickly and easily as possible." *Moses H. Cone Memorial Hospital* v. *Mercury Construction Corp.*, 51 U.S.L.W.

4156, 4161 (U.S. Feb. 23, 1983). Thus, an appeal to this Court after the completion of years of further judicial proceedings could never restore the benefits of arbitration or the protection of the federal statute. If there is to be a meaningful appeal, it must occur now.

"Finality" does not depend on whether the judicial proceedings in the trial court are at an end. *See Hudson Distributors, Inc.* v. *Eli Lilly & Co.*, 377 U.S. 386, 389 n.4 (1964). Rather, determinations of finality are based on a balancing of " 'the inconvenience and costs of piecemeal review on the one hand and the danger of denying justice by delay on the other.' " *Eisen* v. *Carlisle & Jacquelin*, 417 U.S. 156, 171 (1974) (citation omitted). The Court thus employs an "intensely 'practical' approach . . . when applying the finality requirements of . . . 28 U.S.C. § 1257." *Mathews* v. *Eldridge*, 424 U.S. 319, 331 n.11 (1976) (citations omitted). *See also Gillespie* v. *United States Steel Corp.*, 379 U.S. 148, 152-54 (1964).

This Court has ruled that an order denying a stay of judicial proceedings pending arbitration should not routinely be treated as an appealable final judgment.[6] The Court has also recognized, however, that decisions regarding arbitrability constitute final judgments in some circumstances,[7] and that an immediate appeal is appropriate if a decision meets the standards for reviewing a collateral or separable order.[8]

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[6] *See Baltimore Contractors, Inc.* v. *Bodinger*, 348 U.S. 176, 179 (1955); *Shanferoke Coal & Supply Corp.* v. *Westchester Service Corp.*, 293 U.S. 449, 451 (1935).

[7] *Goodall-Sanford, Inc.* v. *United Textile Workers*, 353 U.S. 550, 551-52 (1957).

[8] *See Baltimore Contractors, Inc.* v. *Bodinger*, 348 U.S. at 179 n.4. The courts have permitted interlocutory appeals from decisions denying enforcement of arbitration agreements in two additional situations which, though not directly applicable here, demonstrate a recognition of the need for effective appellate review. First, when the decision regarding arbitrability is rendered by a *federal* court,

The California court's decree in the case at bar falls within the well-recognized line of cases, epitomized by *Cohen* v. *Beneficial Industrial Loan Corp.*, 337 U.S. 541 (1949), and *Cox Broadcasting Corp.* v. *Cohn*, 420 U.S. 469 (1975), in which certain separate and collateral decisions are treated as final judgments even though additional proceedings are anticipated in the courts. *Cohen* permits review of a decision which "finally determines claims of right separable from, and collateral to, rights asserted in the action, too important to be denied review and too independent of the cause itself to require that appellate consideration be deferred until the whole case is adjudicated." [9] *Cox* holds that a ruling by a state court on a federal issue should be immediately appealable, despite the expectation of additional state court proceedings, if (i) the federal issue has been finally decided in

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interlocutory appellate review is often available under 28 U.S.C. § 1292(a)(1) (1976). *See, e.g., Shanferoke Coal & Supply Corp.* v. *Westchester Service Corp.*, 293 U.S. at 451-52; *Ingbar* v. *Drexel Burnham Lambert Inc.*, 683 F.2d 603, 604 (1st Cir. 1982). Second, if one party files a lawsuit and the other party seeks to enforce the arbitration agreement by filing a *separate* judicial action to compel arbitration, the trial court's decision in that separate action is appealable. *See, e.g., Moses H. Cone Mem. Hosp.* v. *Mercury Constr. Corp.*, 51 U.S.L.W. at 4157-59; *University Life Ins. Co. of America* v. *Unimarc Ltd.*, 1982-83 (CCH) Trade Cas. ¶ 65,139, at 71,459-61 (7th Cir. 1983).

For a general discussion of the principles applicable to appeals from decisions regarding arbitrability, *see* Note, *Interlocutory Appeal of Orders Granting or Denying Stays of Arbitration*, 80 Mich. L. Rev. 153 (1981); Dyk, *Appealability of Interlocutory Orders Enjoining or Refusing to Enjoin Commercial Arbitration*, 69 Ky. L.J. 827 (1980-81); Note, *Restraining Effects of the Final Judgment Rule on the Arbitration Process*, 66 Yale L.J. 293 (1956).

[9] 337 U.S. at 546-47. The Court has restated this rule on numerous occasions. *See, e.g., Moses H. Cone Mem. Hosp.* v. *Mercury Constr. Corp.*, 51 U.S.L.W. at 4158; *Firestone Tire & Rubber Co.* v. *Risjord*, 449 U.S. 368, 374-75 (1981); *Coopers & Lybrand* v. *Livesay*, 437 U.S. 463, 468 & n.10 (1978); *Abney* v. *United States*, 431 U.S. 651, 658-59 (1977). *See also National Socialist Party of America* v. *Village of Skokie*, 432 U.S. 43, 44 (1977) (per curiam).

the state courts, (ii) reversal of the state court decision would be preclusive of further litigation on the relevant cause of action rather than merely controlling the nature of the state proceedings, and (iii) refusal to review immediately the state court decision might seriously erode federal policy. 420 U.S. at 482-83.[10]

The California court's resolution of the California Franchise Investment Law issue satisfies these standards.[11] The court's decision conclusively determined the disputed question; is the state court's final word on the matter; will control future litigation; and cannot be relitigated.[12] The issue is also completely separate from the merits of the action. As recognized by the California court, the "issues before [it did] not concern the merits of those disputes, but rather the forum and procedure for their resolution." (J.S. App. 2a.) In addition, reversal by this Court of the state court's decision would terminate the pending judicial litigation, and the parties could then proceed quickly to arbitration. *See Cox Broadcasting Corp.* v. *Cohn*, 420 U.S. at 482-83.

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[10] The decisions cited in note 6, *supra*, largely predate the development of these doctrines. Several commentators have suggested that, in view of the strong public policy favoring arbitration, orders denying arbitration should be appealable in all instances. *See, e.g.*, Notes, *supra* note 8; Dyk, *supra* note 8. However, irrespective of whether refusals to enforce arbitration agreements should always be treated as final orders, the decision of the California Supreme Court in this case is appealable for the reasons stated herein.

[11] Appellees have not challenged the finality of this issue for purposes of appellate review by this Court. *See* Appellees' Motion to Dismiss, Nov. 23, 1982, at 5-7.

[12] *See, e.g., Davies* v. *Krasna*, 14 Cal. 3d 502, 507, 121 Cal. Rptr. 705, 708, 535 P.2d 1161, 1164 (1975) (law of the case must be adhered to in subsequent proceedings and a matter adjudicated on a prior appeal will not be relitigated on a subsequent appeal in the same case).

Moreover, if review is postponed until the end of the litigation, "it will be too late effectively to review the present order and the rights conferred by the statute . . . will have been lost, probably irreparably." *Cohen* v. *Beneficial Industrial Loan Corp.*, 337 U.S. at 546.[13] Given the fact that time-consuming judicial proceedings are the very thing that the parties sought to avoid by agreeing to arbitrate, an appeal after the conclusion of protracted judicial litigation would be only an empty gesture. Indeed, this Court has recently held that in view of the federal statutory policy of "rapid and unobstructed enforcement of arbitration agreements," *Moses H. Cone Mem. Hosp.* v. *Mercury Constr. Corp.*, 51 U.S.L.W. at 4161, the mere deferral by a trial court of a decision on a motion to compel arbitration can satisfy the *Cohen* doctrine. *Id.* at 4158-59. *A fortiori*, the doctrine is satisfied where, as here, the protection of the federal statute has been conclusively denied by the highest court of the state, and several more years of judicial proceedings are accordingly in the offing.

The standards of *Cohen* and *Cox* are particularly applicable here because the issues presented are "too important to be denied review." *Cohen* v. *Beneficial Industrial Loan Corp.*, 337 U.S. at 546. *See Wilko* v. *Swan*, 346 U.S. 427, 430 (1953). This is not a case in which the state court has simply interpreted the agreement of the parties or determined that the right to demand arbitration was waived in a particular case. The issues here are much broader—namely, the power of the states to enact categories of "exceptions" to the Federal Arbitration Act.

Moreover, denial of prompt review in this case "might seriously erode federal policy." *Cox Broadcasting Corp.*

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[13] *Accord, Firestone Tire & Rubber Co.* v. *Risjord*, 449 U.S. at 376 (quoting *Mathews* v. *Eldridge*, 424 U.S. at 331 n.11).

v. *Cohn*, 420 U.S. at 483. The decision of the California Supreme Court has wide ramifications and opens the door to the creation by California or other states of additional classes of nonarbitrable disputes. Much as in *Local No. 438 Construction & General Laborers' Union* v. *Curry*, 371 U.S. 542, 550 (1963), in which a state court had enjoined picketing on the basis of a state law notwithstanding the National Labor Relations Act and the exclusive jurisdiction of the NLRB, "postponing review would seriously erode the national . . . policy requiring the subject matter of respondents' cause to be heard by the . . . Board [arbitrator], not by the state courts."

Finally, it is appropriate for this Court to consider the important issues presented herein at this juncture because, if the case at bar is tried in the California state court and Southland prevails, "there would remain in effect the unreviewed decision of the State Supreme Court" that states may choose to supersede the policies of the Federal Arbitration Act. *Cox Broadcasting Corp.* v. *Cohn*, 420 U.S. at 485. *Accord, Miami Herald Publishing Co.* v. *Tornillo*, 418 U.S. 241, 247 n.6 (1974).

This Court has reviewed appeals in a number of analogous situations. For instance, the denial of a motion to dismiss an indictment on the ground that retrial would expose the defendant to double jeopardy has been held to be an appealable decision. *Abney* v. *United States*, 431 U.S. 651 (1977); *Harris* v. *Washington*, 404 U.S. 55, 56 (1971) (per curiam). The Court recognized in these cases that a second trial would irreparably injure the defendant, irrespective of the ultimate outcome, since the double jeopardy clause is designed to protect a person from being subjected to a second judicial proceeding. As this Court stated in *United States* v. *MacDonald*, 435 U.S. 850, 861 (1978), "a 'right not to be tried' . . . must be upheld prior to trial if it is to be enjoyed at all." The same is true of arbitration. *See also Helstoski* v. *Meanor*, 442 U.S. 500, 506-08 (1979).

This case is also similar to *Mercantile National Bank* v. *Langdeau*, 371 U.S. 555 (1963), in which the Court reviewed as a final judgment a state court's determination of venue, which determination implicated federal law.[14] The Court held that:

> it serves the policy underlying the requirement of finality in 28 U.S.C. § 1257 to determine now in which state court appellants may be tried rather than to subject them, and appellee, to long and complex litigation which may all be for naught if consideration of the preliminary question of venue is postponed until the conclusion of the proceedings.

Id. at 558. As in *Langdeau*, this appeal raises important issues of general applicability concerning the appropriate forum for litigating the dispute.

While concern about unnecessary federal intrusion into state affairs often militates against interlocutory review of a state court decision,[15] there is no such danger here. Under California law, a denial of arbitration is an appealable order[16] and, in fact, *must* be appealed immediately, if at all.[17] For this reason, the case at bar has already been reviewed fully by both the California Court of Appeal and Supreme Court. It would thus be wasteful

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[14] *Accord, American Motorists Insurance Co.* v. *Starnes*, 425 U.S. 637, 642 n.3 (1976).

[15] *See, e.g., North Dakota State Board of Pharmacy* v. *Snyder's Drug Stores, Inc.*, 414 U.S. 156, 159 (1973).

[16] *See* Cal. Code Civ. Proc. § 1294(a). This statute was the basis for Southland's appeals to the California Court of Appeal and Supreme Court.

[17] "The law of this state does not allow, on appeal from a judgment, a review of any decision or order from which an appeal might previously have been taken . . . ." *Morrissey* v. *City and County of San Francisco*, 75 Cal. App. 3d 903, 906, 142 Cal. Rptr. 527, 529 (1977), *hearing denied* (Cal. Sup. Ct. 1978) (citations omitted). *See* Cal. Code Civ. Proc. § 906 (West 1980).

of judicial resources, and pointless, to require this case to work its way through the state court system again before this Court reviews the important issues presented. *Cf. Moses H. Cone Mem. Hosp.* v. *Mercury Constr. Corp.*, 51 U.S.L.W. at 4163. Such a procedure would "result in a completely unnecessary waste of time and energy in judicial systems already troubled by delays due to congested dockets." *Mills* v. *Alabama*, 384 U.S. 214, 217-18 (1966).

2. *The Ruling on the Class Action Issue Is Final*

The California court's decision on the class action arbitration issue is independently appealable as a final judgment. This issue was decided on a writ of prohibition, obtained in a proceeding brought by the franchisees in the California Court of Appeal. (*See supra* pp. 6-7.) It is settled that a state court's final disposition of such a writ is a final judgment reviewable under Section 1257. *See Fisher* v. *District Court*, 424 U.S. 382, 385 n.7 (1976) (per curiam) (and cases cited therein).[18]

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[18] The appellee-franchisees initiated a proceeding in the Court of Appeal seeking such a writ, arguing that the trial court had "acted without or in excess of its jurisdiction" by, *inter alia*, denying them a class arbitration. *See* [Plaintiffs'] Petition for Writs of Mandate or Prohibition, Oct. 3, 1978, at 4-5. (*See also* J.S. App. 48a.) Particularly under California law, such a proceeding "is a distinct suit and the judgment finally disposing of it is a final judgment within the meaning of [what is now Section 1257]." *Bandini Petroleum Co.* v. *Superior Court*, 284 U.S. 8, 14 (1931). *Accord, Rescue Army* v. *Municipal Court*, 331 U.S. 549, 565 (1947). The Court of Appeal granted the writ (J.S. App. 64a), which constituted a final judgment on the matter, *see* Cal. Code Civ. Proc. § 1064 (West 1980), and, under California law, Southland was required immediately to exercise its right of appeal if it wished to obtain any review of the decision. *See id.* §§ 1110 (West 1980), 906; *supra* note 17. The California Supreme Court affirmed the decision and therefore finally disposed of the writ.

In addition, the *Cohen* and *Cox* doctrines, discussed above, are equally applicable to the class action arbitration question. The class action issue poses a collateral matter, separate from the underlying merits of the case. Moreover, a reversal by this Court of the state court's decision would not merely control the nature and character of the judicial proceedings, but would terminate those proceedings so that the parties could proceed promptly to the arbitration forum. *Cox Broadcasting Co.* v. *Cohn*, 420 U.S. at 482-83. The California Supreme Court's creation of a class action arbitration procedure poses important issues of first impression, and threatens to erode the strong federal policy favoring nonjudicial arbitration under the Federal Arbitration Act. (*See* the discussion *infra* at pp. 30-42.)

In their motion to dismiss this appeal, at 6-7, appellees argued that there is no final judgment since no class has yet been certified and since Southland might be able to persuade the trial court to refuse to certify a class. This misses the point, for once a trial court initiates class certification proceedings—including discovery, briefing and a decision, a process bound to take many months—Southland will irretrievably lose its right to be relieved of the costs and delays associated with such judicial proceedings. Regardless of whether the trial court eventually certifies a class, the parties will have been forced to run the gauntlet of expensive and time-consuming procedures in direct contradiction to "the unmistakably clear congressional purpose [in the Federal Arbitration Act] that the arbitration procedure, when selected by the parties to a contract, be speedy and not subject to delay and obstruction in the courts." *Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404 (1967). *Accord, Moses H. Cone Mem. Hosp.* v. *Mercury Constr. Corp.*, 51 U.S.L.W. at 4161 (clear intent of Act is "to move the

parties to an arbitrable dispute out of court and into arbitration as quickly and easily as possible").

Even if Southland prevails in the further proceedings, "there would remain in effect the unreviewed decision of the State Supreme Court" [19] that class action arbitrations may go forward. This time-consuming judicial procedure, which could be used in a wide variety of situations, would discourage arbitration and would increase the burdens on the judicial system.[20]

Thus, applying the "pragmatic approach" by which this Court determines finality for purposes of review, the judgment of the California Supreme Court is a final judgment under 28 U.S.C. § 1257(2).

B. The Issues Presented in This Appeal Were Raised and Litigated in the California Courts

Appellees argued in their motion to dismiss this appeal, at 5-6, that this Court lacks jurisdiction over one of the questions presented (the class action arbitration issue) because Southland allegedly failed to raise that issue in the California courts.[21] Appellees' claim is without merit.

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[19] *Cox Broadcasting Corp.* v. *Cohn*, 420 U.S. at 485. *Accord*, *Miami Herald Publishing Co.* v. *Tornillo*, 418 U.S. at 247 n.6.

[20] *Cf. Mills* v. *Alabama*, 384 U.S. at 217-18; *Moses H. Cone Mem. Hosp.* v. *Mercury Constr. Corp.*, 51 U.S.L.W. at 4163.

[21] The other issue presented by this appeal (*i.e.*, the incompatibility of the Federal Arbitration Act and the anti-arbitration policy in the state's Franchise Investment Law) was raised by the *appellees* in the California Supreme Court. The California Court of Appeal had ruled against the franchisee-plaintiffs on this issue (*see* J.S. App. 66a-70a), and they asked the California Supreme Court to overturn that decision. (*See* [Plaintiffs'] Answer to [Southland's] Petition for Hearing, Oct. 17, 1980, at 31-38.) The California Supreme Court's decision directly addressed the question whether individual states are free to enact statutes overriding the Federal Arbitration Act. (*See* J.S. App. 13a-18a.)

In Southland's petition for hearing in the California Supreme Court, it framed the question presented as "[w]hether a court may enter an order compelling a private commercial arbitration governed by the Federal Arbitration Act and the rules of the American Arbitration Association to proceed as a class action . . . ." (Pet. for Hearing at 2.) Southland argued in its brief that "[u]nder both federal and California law" arbitration is highly favored (*id.* at 6); arbitration is intended to operate outside the judicial system; a class action arbitration would require intimate judicial involvement; and class action procedures would effectively eliminate the benefits of arbitration as a quick, inexpensive, informal alternative to judicial proceedings. (*Id.* at 6-22.) Southland further contended that a class action arbitration would deny absent class members due process of law unless a court closely supervised the arbitrator's conduct, which control would destroy arbitration as the nonjudicial remedy which it is intended to be. (*Id.* at 10-19.) Approximately sixty federal court decisions were cited in Southland's brief in support of these propositions.

Appellees contend that Southland should be deemed to have failed to raise the federal issue because it also relied on state court decisions and on "general policies in favor of arbitration" (Motion to Dismiss at 5-6), and did not argue in the court below "that the Federal Arbitration Act, *as opposed to* the California statute, barred the class action . . . ." (*Id.* at 6 n.2 (emphasis supplied).) However, in view of the fact that this case was pending in state court, it was obviously relevant to direct the court's attention to its own precedents, as well as to decisions rendered by federal courts. Moreover, since Southland and the appellee-franchisees had already *agreed* in the lower courts that the Federal Arbitration Act governed this case, it was unnecessary for Southland to argue at length that the policies of the federal statute—as opposed to the state arbitration law—would be affected by a class

action.[22] Precedents from both federal and state courts were thus germane to the issues presented before the California court.[23]

Where the record before this Court shows that, "either expressly or by clear intendment," a claim as to the invalidity of a state law was brought to the attention of a state court, this Court will regard the claim "as having been adequately presented." *PruneYard Shopping Center* v. *Robins*, 447 U.S. 74, 85 n.9 (1980) (quoting *New York ex rel. Bryant* v. *Zimmerman*, 278 U.S. 63, 67 (1928)). If the state court "actually entertains and decides [the] question adversely to the federal right asserted," [24] or if "the necessary effect of the judgment has been to deny the [federal] claim," then this Court's appellate jurisdiction is invoked.[25]

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[22] In the California Court of Appeal, the franchisee-plaintiffs noted that they "have not challenged Southland's contention that . . . the Federal Arbitration Act is applicable." (Petitioners' Supp. Mem. in re Arbitration in a Class Action, July 10, 1979, at 7.) The Court of Appeal accordingly had no difficulty in concluding that the federal Act governed the case. (J.S. App. 52a-53a.) Thus, in Southland's petition for hearing to the California Supreme Court, it was only necessary to note briefly that "[t]he instant cases are governed by the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.*, since the dispute involves interstate commerce." (Pet. for Hearing at 6 n.6.)

[23] Appellees recognized in the courts below that it was appropriate to rely upon state court decisions even though the class arbitration issue arose under the Federal Arbitration Act. For example, in one of their briefs to the California Court of Appeal, they stated:

> We are willing to accept the proposition that if there were a conflict between federal and state law, the federal law would control. Actually, we have been unable to discover any substantive difference between the federal act and the California statute, at least none that has any bearing on this case.

(Petitioners' Supp. Mem. in re Arbitration in a Class Action, *supra*, at 7.)

[24] *Orr* v. *Orr*, 440 U.S. 268, 276-77 (1979) (quoting *Indiana ex rel. Anderson* v. *Brand*, 303 U.S. 95, 98 (1938)).

[25] *New York ex rel. Bryant* v. *Zimmerman*, 278 U.S. at 67.

Southland brought the class action arbitration issue to the attention of the California courts both "expressly [and] by clear intendment." Moreover, the California Supreme Court decided the issue in the context of the Federal Arbitration Act, which the court and the parties recognized to be the governing law. This Court therefore has appellate jurisdiction.[26]

II. THE FEDERAL ARBITRATION ACT SUPERSEDES THE ANTI-ARBITRATION POLICY OF THE CALIFORNIA FRANCHISE INVESTMENT LAW

The Federal Arbitration Act was enacted in 1925 for the specific purposes of (i) allowing parties to avoid the costliness and delays of litigation and (ii) overruling anti-arbitration policies of various jurisdictions, where interstate commerce is involved.[27] In order to ensure that parties to contracts would be able to resolve their disputes in an informal, nonjudicial forum of their choice,

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[26] Appellees argued in their Motion to Dismiss, at 8, that this Court does not have appellate jurisdiction over the class arbitration issue since no state "statute" was challenged. This is incorrect, as Southland challenged the applicability of the state class action rules to an arbitration proceeding under the Federal Act, which is sufficient to constitute a challenge to a statute. *See Lathrop* v. *Donohue*, 367 U.S. 820, 821, 824-27 (1961). *Cf. In re Griffiths*, 413 U.S. 717 (1973); *Mayer* v. *City of Chicago*, 404 U.S. 189 (1971). *See also King Mfg. Co.* v. *City Council*, 277 U.S. 100, 103-04 (1928); *Williams* v. *Bruffy*, 96 U.S. 176, 183 (1877).

Regardless of whether a state "statute" was challenged, Section 1257(2) clearly applies to the other issue raised by this appeal (federal preemption of the California Franchise Investment Law); the Court therefore has jurisdiction over the entire case. *Cox Broadcasting Corp.* v. *Cohn*, 420 U.S. at 487 n.14.

[27] *See* S. Rep. No. 536, 68th Cong., 1st Sess. 2-3 (1924); *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506, 510-11 (1974). *See also* H.R. Rep. No. 96, 68th Cong., 1st Sess. 1-2 (1924); *Arbitration of Interstate Commercial Disputes: Joint Hearings on S. 1005 and H.R. 646 Before the Subcomms. of the Comms. on the Judiciary*, 68th Cong., 1st Sess. 34-35 (1924) (brief submitted by American Bar Association).

Congress explicitly provided in Section 2 of the Act that an arbitration agreement in any maritime transaction or contract evidencing a transaction involving interstate commerce "*shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.*" 9 U.S.C. § 2 (emphasis supplied).

Section 2 establishes "a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary." *Moses H. Cone Mem. Hosp.* v. *Mercury Constr. Corp.*, 51 U.S.L.W. at 4162. It creates "a body of federal substantive law of arbitrability" and is binding on "state courts, as [well] as federal courts . . . ." *Id.*

The statute establishes only one exception to the rule that arbitration agreements are "valid, irrevocable, and enforceable," namely, doctrines that exist at law or in equity "for the revocation of any contract." 9 U.S.C. § 2. The plain meaning of these words is that arbitration agreements can be invalidated only on the basis of *general principles* of contract formation that are applicable to *any* contract (*e.g.*, fraud, duress, lack of legal capacity), and not on the basis of restrictive laws or doctrines that are aimed at arbitration agreements in particular. Section 2 has been so interpreted by the courts.[28]

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[28] *E.g.*, *American Airlines, Inc.* v. *Louisville & Jefferson County Air Board*, 269 F.2d 811, 816-17 (6th Cir. 1959) (holding that except for "ordinary contract principles" such as "fraud, lack of consideration or capacity or authority to contract," Kentucky policies relating to enforcement of arbitration agreements "must yield to paramount Federal law" under Section 2 of the Act); *World Brilliance Corp.* v. *Bethlehem Steel Co.*, 342 F.2d 362, 364 (2d Cir. 1965) (Section 2 of the Act only permits rescission "for reasons such as fraud, duress, or undue influence"); *Collins Radio Co.* v. *Ex-Cell-O Corp.*, 467 F.2d 995, 997-98 (8th Cir. 1972) ("The plain meaning of § 2 is that federal courts are no longer to apply state statutes and decisions which limit arbitration agreements with rules not applicable to other contracts."); *Medical Development*

In the case at bar, the California Supreme Court held that the state's Franchise Investment Law renders arbitration agreements unenforceable with respect to causes of action brought by franchisees under that statute. A section of that statute, Cal. Corp. Code § 31512, provides that any contractual provision requiring a franchisee to waive compliance with the Franchise Investment Law shall be void. The court ruled that an arbitration agreement constitutes a "waiver" of the right that otherwise would exist to sue in court and, accordingly, that such agreements should not be enforced. Under the court's decision, the arbitration agreement is invalid regardless of whether it was entered into voluntarily by persons with legal capacity, whether it satisfies all other requisites for the making of a valid contract, or whether it provides for an impartial decision under rules such as those of the American Arbitration Association.[20] In other words, the statute invalidates arbitration agreements between franchisors and franchisees irrespective of whether the agreements are valid under general principles of law and equity governing the revocation of contracts.

As applied to interstate contracts such as the ones involved here, the California statute directly contravenes

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Corp. v. *Industrial Molding Corp.*, 479 F.2d 345, 348 (10th Cir. 1973) (same); *Commonwealth Edison Co.* v. *Gulf Oil Corp.*, 541 F.2d 1263, 1269-70 (7th Cir. 1976) (same); *Supak & Sons Mfg. Co.* v. *Pervel Industries, Inc.*, 593 F.2d 135, 137 (4th Cir. 1979) ("While we agree with . . . *Collins Radio* . . . that § 2 is preemptive of conflicting state laws which restrict the validity or enforceability of arbitration agreements, § 2-207 [of the U.C.C.] is not such a law, but is rather a general rule of contract formation.").

[20] The California Supreme Court did not base its decision on any finding that the 7-Eleven arbitration agreement is one-sided or that it would give any unfair advantage to the franchisor. The arbitration clause in the 7-Eleven franchise agreement stipulates that the rules of the American Arbitration Association shall be applied. These established rules, which have been incorporated into tens of thousands of commercial agreements across the country, provide, *inter alia*, for the selection of neutral arbitrators. *See* American Arbitration Association, *Commercial Arbitration Rules* (1982).

Section 2 of the Federal Arbitration Act. It is therefore invalid under the Supremacy Clause of the Constitution (art. VI, cl. 2), which preempts any state statute that "is in direct conflict with federal law, . . . denies rights granted by Congress, or . . . stands as an obstacle to the full effectiveness of a federal statute." *Colorado Anti-Discrimination Commission* v. *Continental Air Lines, Inc.*, 372 U.S. 714, 722 (1963) (footnotes omitted).[30] Under this standard, the California Franchise Investment Law must give way: it directly conflicts with Congress' declaration that interstate arbitration agreements shall be "valid, irrevocable, and enforceable"; it denies a right that is specifically granted by the federal legislation; and it stands in the path of the accomplishment of the objectives of the federal statute—*i.e.*, to invalidate anti-arbitration policies and to place arbitration agreements "upon the same footing as other contracts." H.R. Rep. No. 96, 68th Cong., 1st Sess. 1 (1924).

The California Supreme Court mistakenly relied upon this Court's decision in *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Ware*, 414 U.S. 117 (1973), in support of its conclusion that the California statute is not preempted. (J.S. App. 17a-18a.) *Ware* simply held that the particular state statute at issue in that case was not preempted by a particular federal statute because there was no conflict between them. *Ware* is distinguishable from the case at bar,[31] and indeed, the preemption principles

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[30] *See also Hines* v. *Davidowitz*, 312 U.S. 52, 67 (1941); *Perez* v. *Campbell*, 402 U.S. 637, 649 (1971); *Chicago & N.W. Transp. Co.* v. *Kalo Brick & Tile Co.*, 450 U.S. 311, 317-18 (1981); *Maryland* v. *Louisiana*, 451 U.S. 725, 746-47 (1981).

[31] *Ware* involved an alleged conflict between a state labor code provision exempting wage disputes from arbitration and a New York Stock Exchange rule providing for compulsory arbitration of wage disputes between members of the exchange and their employees. This Court found that there was no conflict between the policies underlying the state statute and the policies underlying the federal securities laws (pursuant to which the stock exchange had

summarized in that case dictate the opposite conclusion here. Unlike the situation in *Ware*, the California statute at issue in this case "frustrates [a] part of the purpose of the federal legislation." 414 U.S. at 139.

The California Supreme Court attempted to justify its decision by analogizing the state Franchise Investment Law to the federal Securities Act of 1933, both of which require disclosures to prospective investors. It reasoned that since this Court had declared in *Wilko* v. *Swan*, 346 U.S. 427 (1953), that preexisting arbitration agreements are nonbinding as to claims arising under the federal statute, the same result should pertain to claims arising under the analogous California statute.

The analogy to *Wilko* is invalid on several grounds.[32] The most important is that *Wilko* did *not* involve a conflict

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promulgated its compulsory arbitration rule), and accordingly held that the state legislation was not preempted by the stock exchange rule. *Ware* did not involve an alleged conflict between a state law and the Federal Arbitration Act. Therefore, as the California Supreme Court acknowledged, "the holding in the case is consequently not controlling here . . . ." (J.S. App. 18a.)

[32] As the dissenting justices in the California Supreme Court recognized, the 1953 decision in *Wilko* was based on this Court's conclusion that arbitration of a securities claim might cause a claimant to waive the specific benefit of the unusually liberal venue provision in the Securities Act of 1933. (*See* J.S. App. 31a-32a.) This Court has suggested that *Wilko* may have been based on that narrow ground. *Scherk* v. *Alberto-Culver Co.*, 417 U.S. at 513-14. The California Franchise Investment Law does not contain a broad venue provision or any other unique benefit similar to the one contained in the federal Securities Act.

Other courts have held that in view of the strong federal policy *favoring* arbitration, the *Wilko* "analogy" should not be extended to other situations. *See Ingbar* v. *Drexel Burnham Lambert Inc.*, 683 F.2d at 605 (rationale of *Wilko* does not extend to claims under Commodities Exchange Act); *Romnes* v. *Bache & Co.*, 439 F. Supp. 833, 838 (W.D. Wis. 1977) (same); *Middle East Transcontinental, Inc.* v. *Onion Crock, Inc.*, 144 Mich. App. 57 (1982) (*Wilko* rationale inapplicable to claims under Michigan Franchise Investment Law).

between a *federal statute* regulating contracts in interstate commerce and a *state law* purporting to limit the federal statute. Rather, *Wilko* involved two federal laws, and the Court in that case was simply called upon to determine whether a particular provision in the subsequently-enacted federal Securities Act of 1933 created an exception to the Federal Arbitration Act of 1925. For this reason, the *Wilko* "analogy" has been held to be inapplicable to conflicts between the Federal Arbitration Act and state laws. For example, in *Allison* v. *Medicab International, Inc.*, 92 Wash. 2d 199, 597 P.2d 380, 382-83 (1979), which involved a state franchise disclosure statute similar to California's, the court stated:

> Plaintiff cites *Wilko* v. *Swan*, . . . where the Supreme Court refused to enforce an arbitration clause when the dispute arose under the federal securities act. However, this case involved two federal acts and not as here the federal arbitration act and a state franchising act. . . .
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> . . . .
>
> We hold that the supremacy clause of the federal constitution must prevail and thus the federal arbitration act requires enforcement of the arbitration clause in the franchise agreement despite the judicial remedies afforded by the [state] Franchise Investment Protection Act.[33]

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[33] *Accord, Barron* v. *Tastee Freez International, Inc.*, 482 F. Supp. 1213, 1216-17 (E.D. Wis. 1980) (Federal Arbitration Act prevails over any anti-arbitration policy of the Wisconsin Franchise Investment Act). In the instant case, the three-judge panel of the California Court of Appeal, as well as the two dissenting justices in the California Supreme Court, agreed that the federal policy favoring arbitration supersedes any effort by California to prohibit arbitration covered by the Federal Arbitration Act. (J.S. App. 31a-37a, 66a-70a.) *See also, e.g., Bache Halsey Stuart Shields, Inc.* v. *Moebius*, 531 F. Supp. 75 (E.D. Wis. 1982); *R.J. Palmer Construction Co.* v. *Wichita Band Instrument Co.*, 7 Kan. App. 2d 363, 642 P.2d 127 (1982); *Merrill Lynch Pierce Fenner & Smith Inc.* v. *Melamed*, 405 So. 2d 790 (Fla. Dist. Ct. App. 1981).

The California Supreme Court conceded that the Federal Arbitration Act overrides any state policy that might be hostile "to arbitration generally" (J.S. App. 15a), but it stated that the Act allows the states to adopt "exceptions" to the general principle of arbitrability. (J.S. App. 16a.) The California court made no effort to define the subject areas or scope of the permissible "exceptions," and there is in fact no principled basis for its decision. This year's exception could be for franchisor-franchisee disputes, next year's could be for disputes between lenders and borrowers or landlords and tenants, and the following year the state might ban the arbitration of tort claims. The state could easily identify a "public policy" supporting a wide range of such "exceptions," and could thereby undermine the federal statute. More fundamentally, the California Supreme Court's rationale is contradicted by the express language of Section 2 of the Arbitration Act, which overrides "any state substantive or procedural policies to the contrary." *Moses H. Cone Mem. Hosp.* v. *Mercury Constr. Corp.*, 51 U.S.L.W. at 4162.

The California court's decision would also impair arbitration by inviting "unseemly and mutually destructive jockeying by the parties to secure tactical litigation advantages." *Scherk* v. *Alberto-Culver Co.*, 417 U.S. at 516-17. A party desiring to avoid arbitration could, through artful pleading, structure his claims so as to fit within one of the state-created "exceptions" to arbitration.[34] This

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[34] This case offers a good example of the possibilities for such maneuvering. The claim in this litigation is that Southland misled the plaintiffs by misstating and failing to disclose material facts at the time they franchised their 7-Eleven stores. Accordingly, the primary allegation in plaintiffs' original pleadings was that Southland had engaged in intentional and negligent fraud in violation of common law. However, after the trial court ruled that claims based on the California Franchise Investment Law were nonarbitrable, new complaints were filed in two of the consolidated cases (*Coy* and *Scovis*); these pleadings contained a single count, based on the

Court should not countenance such results. Just as the stability of international business transactions would be undercut if one country were to refuse to enforce international arbitration agreements based on parochial concerns, *Scherk* v. *Alberto-Culver Co.*, 517 U.S. at 516-17, orderliness and predictability in interstate commerce would be impaired if individual states were free to create "exceptions" to the arbitrability of disputes involving interstate contracts.

It is also important to prevent the erosion of the Federal Arbitration Act because of the statute's important role in the administration of justice. Court congestion and delay were among the primary reasons for enacting the statute in 1925, and are now of far greater proportions.[35]

Franchise Investment Law. Plaintiffs' counsel candidly conceded to the trial court that they had phrased the claims as statutory violations, and not as common law causes of action, for the express purpose of avoiding the contractual commitment to arbitrate the disputes. *See* [Plaintiffs'] Memorandum of Points and Authorities in Opposition to Petition to Compel Arbitration, July 17, 1978, at 3-4, where plaintiffs' attorneys stated to the trial court:

> [M]ay these plaintiffs . . . avoid arbitration by limiting their complaints to causes of action under the Franchise Investment Law? The answer to this question is clearly: yes, of course they can. . . . Having had the benefit of guidelines provided by the Court, plaintiffs' counsel have filed pleadings best calculated to both present the essential claims of the particular plaintiffs involved, and to plead an effective class action . . . .

[35] From 1940 to 1982, annual federal district court civil case filings increased from approximately 35,000 to 206,000. Federal civil cases increased almost six times as fast as population, and despite a significant increase in the number of federal district court judges, the yearly civil filings per judgeship doubled between 1940 and 1982, from approximately 180 to 400 cases. Class action cases are responsible for a significant degree of the burdens imposed upon judges. *See* Administrative Office of the United States Courts, *1982 Annual Report of the Director* 3 (prelim. ed. 1982); Administrative Office of the United States Courts, *1981 Annual Report of the Director* 3-4, 56-59, 82-83 (prelim. ed. 1981); Administrative Office of the United States Courts, *1980 Annual Report of the Director* 2-4,

Therefore, the courts have recognized that arbitration should be encouraged and that the Federal Arbitration Act should be applied in a liberal fashion in favor of enforcing arbitration agreements. *Moses H. Cone Mem. Hosp.* v. *Mercury Constr. Corp.*, 51 U.S.L.W. at 4162, 4161 n.27.

Quite recently, Congress has explicitly reaffirmed the desirability of arbitration as an alternative to costly, time-consuming litigation in the courts. In the patent and trademark appropriations bill for 1983-85, Pub. L. No. 97-247, 96 Stat. 317 (1982), Congress overruled a line of lower court decisions which had held that "public policy" precluded arbitration of disputes concerning patent validity or infringement. *Id.* § 17(b), 96 Stat. 322 (to be codified at 35 U.S.C. § 294). In explaining this provision, the House Report emphasized that arbitration benefits not only the parties to a particular dispute but also the public at large by reducing the burdens on the courts:

> The advantages of arbitration are many: it is usually cheaper and faster than litigation; it can have simpler procedural and evidentiary rules; it normally minimizes hostility and is less disruptive of ongoing and future business dealings among the parties; it is often more flexible in regard to scheduling of times and places of hearings and discovery devices; and, arbitrators are frequently better versed than judges and juries in the area of trade customs and the technologies involved in these disputes.
>
> The enforcement of voluntary arbitration would serve the public in two ways. First, . . . [it] will enhance the patent system . . . . Secondly, arbitration

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54-58 (1980); Burger, *Isn't There a Better Way*, 68 A.B.A.J. 274, 275 (1982) (address to ABA). *See also* Kirkham, *Problems of Complex Civil Litigation*, 83 F.R.D. 497, 499-501 (1979) (congestion in courts). The congestion is not confined to the federal courts. *See, e.g., Judicial Conference for the District of Columbia Circuit*, 89 F.R.D. 169, 175 (1980) (remarks of Burger, C.J.).

could relieve some of the burdens on the overworked Federal courts. Chief Justice Burger in his speech to the American Bar Association on January 24, 1982, generally endorsed the use of arbitration to reduce the judicial backlog.[36]

In sum, state-created "exceptions" to the Federal Arbitration Act would fly in the face of the language of Section 2 of the federal statute; frustrate Congress' intent to establish a national policy favoring arbitration of interstate commercial disputes; encourage parties to end-run their arbitration agreements and engage in forum shopping; and add to the burdens of crowded court dockets. For all of these reasons, this Court should reverse the decision of the California Supreme Court.

III. CLASS ACTIONS ARE INCONSISTENT WITH ARBITRATION UNDER THE FEDERAL ARBITRATION ACT

The procedures of arbitration and class actions are fundamentally incompatible. The proceeding authorized by the court below would be an arbitration in name only and would deprive the parties of the informal, nonjudicial procedure protected by the Federal Arbitration Act.

A. The Essence of Arbitration Is Its Avoidance of Judicial Procedures; Class Actions Require Active Judicial Involvement

Arbitration is a contractual method of dispute resolution that is intended to take place outside of the judicial system, without interference by the courts and without

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[36] H.R. Rep. No. 542, 97th Cong., 2d Sess. 13 (1982), *reprinted in* 1982 U.S. Code Cong. & Ad. News 765, 777. Another recent statute in which Congress has stressed the need for developing viable alternatives to litigation in the courts is the Dispute Resolution Act, Pub. L. No. 96-190, 94 Stat. 17 (1980) (codified at 28 U.S.C. app. §§ 1-10 (Supp. V 1981)). *See also* H.R. Rep. No. 1654 (Part 1), 95th Cong., 2d Sess. 7-11 (1978); *Report of the Pound Conference Follow-Up Task Force*, 74 F.R.D. 159, 169, 179-81 (1976) (discussing the advantages of arbitration and recommending its increased use).

adherence to conventional judicial procedures. By choosing arbitration, parties agree to forego full judicial procedures and instead elect to have one or more umpires of their choosing, often experts in the subject matter of the dispute, hold an informal hearing and reach a prompt decision. The arbitrators enjoy wide latitude in conducting the proceedings. Judicial machinery—such as pretrial discovery, the rules of evidence, the automatic right to appeal, a written transcript, and the necessity of rendering carefully articulated written decisions—are not applicable. Parties frequently conclude that lawyers are unnecessary in this informal setting. Moreover, arbitrators—unlike courts—need not consider the impact of their decision as precedent that may be applicable to nonparties to the controversy; arbitration thereby facilitates prompt decisions and discourages parties from overlitigating a dispute because of concerns that an adverse decision may extend beyond the particular facts at issue.[37]

Waiver of judicial procedures goes to the heart of arbitration. Arbitration "isn't 'just like the courts.' In fact, its strongest points lie in those areas where it most widely differs from the courts." M. Domke, *The Law & Practice of Commercial Arbitration* § 1.01, at 2. Thus, it has repeatedly been held that arbitration should not be encumbered with procedures that might delay or complicate the proceedings, or require judicial intervention when

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[37] *See, e.g., Bernhardt* v. *Polygraphic Co. of America*, 350 U.S. 198, 203 & n.4 (1956); *United Steelworkers* v. *Enterprise Wheel & Car Corp.*, 363 U.S. 593, 598 (1960). For a discussion of the informality of arbitration and its differences from judicial litigation, *see generally* A. Widiss, *Arbitration: Commercial Disputes, Insurance, & Tort Claims* 6-7, 339 (PLI 1979); M. Domke, *The Law & Practice of Commercial Arbitration* § 24.02 at 235-39, § 24.07 at 252, § 25.01 at 255-56, § 26.01 at 265-66, § 27.01 at 271-72, § 29.06 at 286-89, and pp. 312-13 (1968); Rehnquist, *A Jurist's View of Arbitration*, 32 Arb. J. 1, 5-7 (1977).

the arbitration is in progress.[38] As Judge Learned Hand stated in *American Almond Products Co.* v. *Consolidated Pecan Sales Co.*, 144 F.2d 448, 451 (2d Cir. 1944):

> Arbitration may or may not be a desirable substitute for trials in courts; as to that the parties must decide in each instance. But when they have adopted it, they must be content with its informalities; they may not hedge it about with those procedural limitations which it is precisely its purpose to avoid.

The court below has not only "hedged" the arbitration with judicial procedures; it has created a mechanism that would be conducted by the judiciary from start to finish.

Class actions are the paradigm example of large, time-consuming, rigorously-regulated, difficult-to-manage judicial proceedings. They require more judicial supervision than do other court proceedings, and more rigid adherence to formalities. Because they bind the rights of persons who have not sued or personally appeared and who do not control the lawsuit, class actions pose delicate constitutional issues. They satisfy federal due process standards only if, and to the extent that, the named plaintiff's claim is typical of those of other class members, the best practicable notice is given to the class, and the named plaintiff and his counsel fully and adequately represent the interests of the class.[39]

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[38] *See, e.g., Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*, 388 U.S. at 404; *Moses H. Cone Mem. Hosp.* v. *Mercury Constr. Corp.*, 51 U.S.L.W. at 4161; *Cavanaugh* v. *McDonnell & Co.*, 357 Mass. 452, 457, 258 N.E.2d 561, 564 (1970); *De Sapio* v. *Kohlmeyer*, 35 N.Y.2d 402, 406, 362 N.Y.S.2d 843, 847, 321 N.E.2d 770, 773 (1974).

[39] *See, e.g., Hansberry* v. *Lee*, 311 U.S. 32, 42-43, 45 (1940); *Sam Fox Publishing Co.* v. *United States*, 366 U.S. 683, 691 (1961); *H.L.* v. *Matheson*, 450 U.S. 398, 432 n.9 (1981) (Marshall, J., dissenting); *Robertson* v. *National Basketball Ass'n*, 556 F.2d 682, 685-86 (2d Cir. 1977); *Gonzales* v. *Cassidy*, 474 F.2d 67, 74 (5th Cir. 1973).

Absent class members cannot constitutionally be bound by the result of the proceeding unless there has been active judicial participation in all aspects of the litigation. For example, discovery, briefing and a hearing are usually required before the court decides whether to certify a class.[40] The court must carefully define the class, determine the best practicable form of notice to the class, and approve the content of the notice.[41] Class members then must be allowed to opt out of the litigation.[42]

After completion of these preliminary proceedings, which normally consume many months,[43] the court must continue to supervise all phases of the litigation to ensure that the named plaintiff's interests are compatible with those of the class and that plaintiff is a vigorous and effective class representative.[44] If, at *any* time, the initial class certification appears to have been erroneous, the class

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[40] *See General Telephone Co.* v. *Falcon*, 457 U.S. 147, 102 S. Ct. 2364, 2372 (1982) (often necessary to "probe behind the pleadings" to decide class issues); *Coopers & Lybrand* v. *Livesay*, 437 U.S. at 469 & n.12 (class certification issues usually " 'enmeshed in the factual and legal issues comprising the plaintiff's cause of action' "); *Alabama* v. *Blue Bird Body Co.*, 573 F.2d 309, 312, 322-24 (5th Cir. 1978); *Belcher* v. *Bassett Furniture Industries, Inc.*, 588 F.2d 904, 906 (4th Cir. 1978).

[41] *Oppenheimer Fund, Inc.* v. *Sanders*, 437 U.S. 340, 357 n.24 (1978); *Eisen* v. *Carlisle & Jacquelin*, 417 U.S. at 173-74.

[42] Fed. R. Civ. P. 23(c). (*See also* the decision of the California Supreme Court at J.S. App. 28a.)

[43] Frequently, a year or more will be consumed in class action discovery, briefing and hearings alone. *See, e.g., In re Transit Co. Tire Antitrust Litigation*, 67 F.R.D. 59, 63, 72 (W.D. Mo. 1975); *Sommers* v. *Abraham Lincoln Federal Savings & Loan Ass'n*, 66 F.R.D. 581, 585 (E.D. Pa. 1975).

[44] *E.g., In re Fine Paper Antitrust Litigation*, 617 F.2d 22, 27 (3d Cir. 1980); *Susman* v. *Lincoln American Corp.*, 561 F.2d 86, 89-90 (7th Cir. 1977); *National Ass'n of Regional Medical Programs, Inc.* v. *Mathews*, 551 F.2d 340, 344-46 (D.C. Cir. 1976), *cert. denied*, 431 U.S. 954 (1977).

must be realigned or decertified.[45] And if the claims are amended, or if other significant events occur, the court may require or authorize supplemental notices to the class.[46] If either the plaintiff or the defendant wishes to communicate with class members, the court may need to act to prevent misrepresentations or other abuses.[47]

The court's supervisory duties in a class action also extend to the actual hearing of the case and to any proceedings that occur thereafter. The court must ensure that the named plaintiff's evidence is "common," class-wide evidence.[48] Transcripts of the proceedings must be prepared, and the court must render written decisions, so that other courts can ascertain the scope of the class and of the judgment. Moreover, even if the court's decision has been clearly delineated, a class member can appeal from an adverse verdict, or attempt to avoid the res judicata effects thereof, by contending that the evidence was not "common" and/or that he was not adequately represented; if these requirements were not satisfied, the verdict cannot be binding on him.[49] In a class action, the

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[45] *General Telephone Co.* v. *Falcon*, 102 S. Ct. at 2372; *Coopers & Lybrand* v. *Livesay*, 437 U.S. at 469 & n.11; *H.L.* v. *Matheson*, 450 U.S. at 432 n.11 (Marshall, J., dissenting); *Social Services Union, Local 535* v. *County of Santa Clara*, 609 F.2d 944, 948-49 (9th Cir. 1979); *Guerine* v. *J & W Investment, Inc.*, 544 F.2d 863, 864 (5th Cir. 1977).

[46] *See, e.g.*, Fed. R. Civ. P. 23(d)(2); 7A C. Wright & A. Miller, *Federal Practice & Procedure* § 1791 at 193-94, § 1793 at 201, 207-11 (1972).

[47] *Gulf Oil Co.* v. *Bernard*, 452 U.S. 89, 100 (1981).

[48] *See General Telephone Co.* v. *Falcon*, 102 S. Ct. at 2372. After trial of the "common" issues, there may be hundreds of additional hearings on "individual" issues, such as damages. *E.g.*, *International Brotherhood of Teamsters* v. *United States*, 431 U.S. 324, 361 (1977); *EEOC* v. *Korn Industries, Inc.*, 682 F.2d 256, 260-61 (4th Cir. 1981).

[49] *E.g.*, *Gonzales* v. *Cassidy*, 474 F.2d 67 (5th Cir. 1973).

parties cannot even settle their dispute without judicial review and approval.[50]

In short, class actions require intimate, ongoing judicial management at every stage.

The California Supreme Court recognized that these essential class action procedures, which arise from due process considerations, cannot properly be performed by arbitrators. It therefore acknowledged that in a purported class action arbitration, *the court* would conduct the certification proceedings, monitor the adequacy of representation, review any proposed settlements, and so forth. (J.S. App. 28a-29a. *See also* the decision of the Court of Appeal at J.S. App. 64a.) The court attempted to downplay the extent to which a judge would be involved but conceded that the judiciary would be required to participate actively throughout the arbitration.

B. A Class Action Arbitration Would Violate the Federal Arbitration Act by Destroying the Parties' Agreement To Arbitrate

It is difficult to imagine a procedure more alien to the spirit of arbitration. The mechanism contemplated by the court below would seriously affect the viability of the rights guaranteed by the Federal Arbitration Act in many ways. For example:

—a procedure designed to operate outside the judicial system would require careful and continuous judicial participation;

—a mechanism intended to operate informally would be transformed into one involving detailed, legalistic procedures;

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[50] *In re General Motors Corp. Engine Interchange Litigation*, 594 F.2d 1106, 1124 & n.21 (7th Cir.), *cert. denied*, 444 U.S. 870 (1979); *Mandujano* v. *Basic Vegetable Products, Inc.*, 541 F.2d 832, 835-36 (9th Cir. 1976); *Grunin* v. *International House of Pancakes*, 513 F.2d 114, 120-24 (8th Cir.), *cert. denied*, 423 U.S. 864 (1975); *Greenfield* v. *Villager Industries, Inc.*, 483 F.2d 824, 831-34 (3d Cir. 1973); *Officers for Justice* v. *Civil Service Commission*, 688 F.2d 615, 624-25 (9th Cir. 1982). *See also* Fed. R. Civ. P. 23(e).

—a procedure designed to simplify the litigation would become more complex than if the litigation had remained in court in the first place; the parties would litigate their dispute in two forums rather than one, and there would be substantial overlaps between the roles of the judge and arbitrator;

—a mechanism intended to be quick and inexpensive would become protracted and expensive;

—a procedure designed to permit parties to resolve a dispute privately, and without disrupting ongoing contractual relationships, would become a highly publicized, high-stakes lawsuit;

—a procedure designed to facilitate compromise would inhibit settlements by burdening them with costly and time-consuming procedural hurdles; and

—parties would be less willing to enter into arbitration agreements since the risks associated with arbitration would be significantly increased while its efficiency and privacy would be diminished.

Class actions and arbitrations are each a useful procedural tool for resolving disputes. This Court need not decide that one is good and the other bad. But the two are like oil and water and cannot be mixed; the use of both at the same time would not be true to the objectives or procedures of either. One emphasizes speed, simplicity, informality and privacy, while the other requires caution, complexity, strict adherence to established procedures, and publicity. As the dissenting opinion in the court below aptly noted, a class action arbitration necessarily would "require close court supervision and frequent intervention antithetical to the essential informal and nonjudicial nature of the arbitration process." (J.S. App. 45a.)[81]

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[81] The fundamental inconsistency between the two types of proceedings was recognized in the only other reported decision to consider the propriety of a class action arbitration. In *Harris* v. *Shearson Hayden Stone, Inc.*, 82 A.D.2d 87, 441 N.Y.S.2d 70, 75-76 (1981), *aff'd mem.*, 56 N.Y.2d 627, 450 N.Y.S.2d 482, 435 N.E.2d

The California Supreme Court ignored this incompatibility and justified its decision by erroneously assuming that individual, small claims might be "effectively foreclos[ed]" unless claimants are able to aggregate their resources by bringing class actions. (J.S. App. 25a.) The court overlooked the fact that the objectives of class actions (relieving burdens on the courts, reducing the cost of prosecuting individual claims) are served by arbitration in another way. Arbitration assists the administration of justice by consensually removing cases from the often tortuous route of the judicial system and by providing a quick, informal, inexpensive remedy to facilitate the prosecution of claims—particularly small claims. In other words, arbitration satisfies the principal goals that led to the creation of class actions without the delay, burden and expense which accompanies that judicial procedure. *Cf. Harris* v. *Shearson Hayden Stone, Inc.*, 441 N.Y.S.2d at 76.[52]

The California Supreme Court was unrealistic when it suggested that hundreds of individual, duplicative arbitrations would occur unless it created an unprecedented class action procedure. (*See* J.S. App. 25a, 29a.) The court cited no evidence that this sort of wasteful practice has occurred, and we believe that none exists for several reasons. First, the typical case involves only one or a few

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1097 (1982), the court held that a party should not be permitted to avoid arbitration of his individual claim by filing a class action in court. A dissenting justice felt that the policy favoring class actions should prevail over the policy favoring arbitration, but even he recognized that a class action necessarily is a *judicial* procedure, unsuited to the arbitration setting. 441 N.Y.S.2d at 79.

[52] Our research has not revealed any studies or commentary supporting the proposition that individual arbitration has tended to thwart the prosecution of individual claims. Nor, prior to the decisions of the California courts in this case, was there any support for that proposition in case law. Moreover, in the court below, the plaintiff-franchisees did not allege that it would be impossible or impractical to prosecute individual claims. Indeed, all of the plaintiffs are represented by the same attorneys and yet they filed some of the cases individually and some as purported class actions.

claims, not hundreds or thousands. Class actions stir up litigation to some extent by creating claimants who have not previously felt aggrieved and who are not affirmatively interested in filing suit.[53] Thus, the true alternative to a class action in the instant litigation—and most others—is arbitration with a few claimants, not hundreds. Second, even if hundreds of claims were asserted, it is wrong to assume that it would be necessary to duplicate the expense of individually arbitrating each one. Substantial economies could be achieved by retaining the same attorneys (as plaintiffs have done here), hiring the same expert witnesses, and so forth. Third, if a number of arbitrations were decided in favor of one side or the other, the parties would likely conform their conduct to the results of those arbitrations, or the arbitrators would give precedential weight to the outcome of prior cases. Fourth, in positing that the "alternatives" were a single class action or hundreds of individual hearings, the court below overlooked the fact that a class action arbitration would *not* eliminate the need for individual trials on "non-common" issues such as damages, affirmative defenses and counterclaims.

In any event, the Federal Arbitration Act does not authorize the courts to interfere with arbitration on the ground that some other procedure would be more "efficient." *See Moses H. Cone Mem. Hosp.* v. *Mercury Constr. Corp.*, 51 U.S.L.W. at 4161. An agreement to arbitrate is, in effect, "a specialized kind of forum-selection clause that posits not only the situs of the suit but also *the procedure to be used* in resolving the dispute." *Scherk* v. *Alberto-Culver Co.*, 417 U.S. at 519 (emphasis supplied). And, as the court stated in *Dickinson* v. *Heinold Securities, Inc.*, 661 F.2d 638, 646 (7th Cir. 1981):

> [T]he Arbitration Act requires that we enforce the bargain of the parties as to dispute resolution and

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[53] *Cf. Gulf Oil Co.* v. *Bernard*, 452 U.S. at 100 nn.11 & 12 (potential of class action for "stirring up" litigation).

> not substitute our own views of economy and efficiency. There is no room in the language of the Act, the decisions of the Supreme Court or the decisions of this court for an ad hoc approach, based on speculative considerations of efficiency toward enforcement of arbitration agreements.[54]

The Federal Arbitration Act must be enforced by state courts, and it prevails over "any state substantive *or procedural* policies to to the contrary." *Moses H. Cone Mem. Hosp.* v. *Mercury Constr. Corp.*, 51 U.S.L.W. at 4162 (emphasis supplied). Thus, appellees' contention that the states are free to encumber interstate arbitrations with judicial paraphernalia so long as they do so with "procedural" devices is without merit. (*See* Motion to Dismiss at 10-14.)

The California Supreme Court recognized that its class action device would be radically different than a normal arbitration and accordingly held that a party "should be given the option of remaining in court rather than submitting to classwide arbitration." (J.S. App. 30a.) A person presented with this Hobson's choice would almost surely elect the judicial forum. While parties to contracts are often willing to forego their rights of appeal, discovery, and adherence to rules of evidence in the context of an informal arbitration, waiver of these protections would involved decidedly different considerations in the context of a massive class action involving hundreds of litigants. Moreover, a class action arbitration would necessarily involve overlapping responsibility between two tribunals and would be even more complex, protracted and uncertain than a *judicial* class action. Thus, in the end, there likely would not be *any* arbitration at all: the parties would opt for the "simpler" judicial class action, and the agreement to arbitrate would be circumvented as a direct result of the judicially-imposed class action procedures.

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[54] *See also, e.g., De Sapio* v. *Kohlmeyer*, 35 N.Y.2d at 406, 362 N.Y.S.2d at 847, 321 N.E.2d at 773.

The decision of the court below would also have an adverse impact on the availability of qualified arbitrators. An arbitrator would have very little independence in the kind of two-ring proceeding contemplated by the California Supreme Court since he or she would be second-guessed by a judge at every stage. Skilled accountants, architects, contractors and other potential arbitrators would be deterred by the legalisms, complexities and judicial controls of a class action; and the prospect of presiding over hundreds of individual damage hearings after the hearing on the "common" issues would further reduce the parties' ability to obtain qualified arbitrators.

In sum, a class-action arbitration would seriously impair, if not destroy, the parties' federally protected agreement to arbitrate.

CONCLUSION

For all of the reasons stated above, the decision of the California Supreme Court should be reversed, and the cases should be remanded with the instruction that the parties should proceed to arbitrate their disputes on an individual basis.

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THE SOUTHLAND CORPORATION, et al.,
Appellants,

vs.

RICHARD D. KEATING, et al.,
Appellees.

On Appeal from the Supreme Court of California

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No. 82-500

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1982

THE SOUTHLAND CORPORATION, et al.,
Appellants,

VS.

RICHARD D. KEATING, et al.,
Appellees.

On Appeal from the Supreme Court of California

BRIEF OF APPELLEES

STATEMENT OF THE CASE

All of the plaintiffs are California franchised operators of 7-Eleven convenience stores—the modern day corner grocery. The substantive rights sued upon are all governed by state law. In the state courts, Southland sought to compel arbitration under both the state and federal acts. The Federal Arbitration Act (hereinafter "FAA") was held applicable because Southland is located in Texas and the 7-Eleven chain bears a federally registered trademark.

Southland's "Questions Presented" mischaracterize the issues before this Court. The first question leaves out crucial language of the FAA denying the enforceability of arbitration clauses "upon such grounds as exist at law or in equity for the revocation of any contract." The California Supreme Court phrased the preemption issue more accurately: "[W]hether the principles of *'substantive federal law'* embodied in the FAA, preclude a state from protecting its franchise investors through a system of statutory regulation including nonwaivable judicial remedies." J.S. App. 14a-15a.[1]

Southland's statement of the second issue is likewise highly misleading. The California Supreme Court did not superimpose judicial class action procedures on a private arbitration. It remanded the action to the superior court to determine whether the possibility of class arbitration could save the arbitration clause in this adhesion contract from being declared unconscionable under general principles of California contract law. The California Supreme Court stated the matter as follows:

> One possible solution to this dilemma would be to hold that arbitration agreements contained in contracts of adhesion may not operate to stay properly maintain-

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[1]The following abbreviations are used herein: The Appendix to Southland's Jurisdictional Statement is cited as "J.S.App."; Southland's Jurisdictional Statement as "J.S."; the Joint Appendix as "Jt. App."; and Southland's Opening Brief as "Op. Br."

> able class actions . . . . The statutes and public policy supportive of arbitration, require, however, that this result be avoided if means are available to give expression to the basic arbitration commitment of the parties.

J.S.App. 25a-26a. The court found no theoretical barrier under California law to such procedure and ordered the trial court to consider classwide arbitration as one possible solution, leaving Southland the option of remaining in court if it so chose. J.S.App. 29a-30a.

The California Supreme Court's concern was well justified on the facts of this case. Southland attempts to disguise its motivation in moving to compel arbitration by falsely asserting that this action began with the filing of the *Keating* complaint in May of 1977, and that new and complex accounting issues were raised in *Keating* which caused Southland suddenly to abandon litigation in the courts for arbitration.[2] The truth is that the only difference between *Keating* and the other franchise actions Southland had been litigating for two years was that *Keating* sought classwide relief. Southland's sole motivation in moving to compel arbitration was to defeat the class action. The California Supreme Court's decision is not antiarbitration, it merely refuses to permit an adhesive arbitration provision to be used to shield a party with superior bargaining power from classwide accountability for classwide wrongs.

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[2]The accounting issue which Southland asserts as its reason for moving to arbitrate was first raised as one of the allegations of intentional misrepresentation in the 1975 *Gouveia* complaint. The issue was later amplified in the *Battersby* complaint which was filed three months *after* Southland made its motion to compel arbitration in *Keating*. Subsequently, in connection with a motion to coordinate, all of the franchisees amended their complaints to mirror the *Battersby* allegations. The allegations of the First Amended Complaint in *Keating* included in the joint appendix are typical of all the franchisees' amended complaints. Jt.App. 12-25. The coordination proceedings and amended pleadings affected the state court's determination of waiver, J.S.App. 21a-22a, but had nothing to do with Southland's original decision to seek arbitration.

SUMMARY OF THE ARGUMENT

I. Southland fails to demonstrate that this Court has jurisdiction over either of the issues presented for review. The question whether the FAA preempts the California Franchise Investment Law cannot be reached because it is outside the scope of the arbitration clause in Southland's standardized agreement. Second, whether California may consider a class arbitration proceeding was raised and decided as an issue of state law below. It cannot be presented here for the first time as a question of federal law. Third, the California Supreme Court's decision is not final.

The court remanded the action to the trial court for determination of whether a class should be certified and, if so, to explore the possibility of a class arbitration proceeding in order to save Southland's adhesive arbitration provision from being declared invalid under general principles of California contract law. Because of the presence of non-arbitrable classwide statutory claims, the trial court could exercise its equitable jurisdiction to entertain the entire class action in court. The uncertain posture of the case prevents meaningful review by this Court at this juncture. Nor is there any need for this Court to step in before further proceedings take place. The California court's directive on remand does not undermine any federal policy.

II. California has a longstanding policy like that of the federal government favoring the enforcement of arbitration agreements for common law disputes. But neither government considers this policy to mean that arbitration is a suitable forum for determining important statutory rights. The very same features which make arbitration desirable for resolving ordinary contract disputes make it an inappropriate forum for scrutiny of alleged unlawful conduct and vindication of important governmental policies.

Congress has allowed state law to operate vigorously in the area of franchise investment regulation. In passing California's Franchise Investment Law, the state legislature consciously adopted the very same anti-waiver pro-

vision which Congress found essential to the protection of investors covered by the federal securities acts. It is highly unlikely that Congress would have intended to cripple the effectiveness of such legislation by prohibiting investors' access to the courts to receive the protection guaranteed by the state legislature. An intent to preempt simply cannot be inferred where the state legislative scheme is modeled after a similar federal legislative scheme and furthers the same policies.

The FAA is restrictive in scope. It expressly defers to applicable state law on issues of validity. Under California law any contract provision which purports to waive compliance with the Franchise Investment Law is invalid and, thus, not within the coverage of the FAA. The Act cannot be interpreted otherwise.

It is an essential function of state courts to enforce important state policies. Under our federal system, congressional authority to control the forum for resolution of state-created rights is at a minimum. In enacting its own legislation, Congress has deemed numerous rights important enough to require access to the courts to ensure their effective implementation. An interpretation of the FAA to bar the states from implementing parallel policies in the same manner would serve no legitimate federal interest. If so interpreted, the FAA would be an unconstitutional exercise of congressional power under the Commerce Clause.

III. The California court's decision with respect to arbitration of the common law claims is not in conflict with the FAA. Applying general principles of contract law, the California court decided that the arbitration agreement in question, being part of an adhesion contract, is only valid if it does not operate to insulate Southland from a class remedy for classwide wrongs. It therefore authorized the trial court, on remand, to entertain a class motion and, if appropriate, to use its equitable powers to fashion a suitable procedure by means of a consolidated or class arbitration.

The FAA does not control state court procedures. Consolidation is often more complicated and intrusive to the basic agreement than a class procedure would be. Class arbitration would involve a representative franchisee litigating the same claim for all injured parties. It is far better than Southland's two alternatives: (1) numerous duplicative arbitration proceedings with potentially inconsistent results; or (2) only a few scattered arbitrations with those franchisees having enough at stake to arbitrate identical claims one-on-one with a franchisor of vastly superior economic resources. The former is far more costly and inefficient than a class arbitration; the latter would totally undermine the strong state policy in favor of classwide accountability for classwide wrongs. The California Supreme Court's attempt to equalize the parties while preserving the choice of forum is a laudable experiment in accommodating both the policy favoring arbitration and the policy favoring class actions.

ARGUMENT

I

THIS COURT DOES NOT HAVE JURISDICTION OVER THIS CASE

This Court has reserved the question of jurisdiction pending the hearing on the merits. Southland has the burden of affirmatively establishing jurisdiction on both of the issues presented. *Republic Natural Gas Co. v. Oklahoma*, 334 U.S. 62, 70-71 (1948). It fails to do so. First, as a threshold matter, this Court must determine whether Southland's arbitration clause is broad enough to include claims under the Franchise Investment Law. Second, the class arbitration issue was not raised as a federal question below. Third, the decision below is not a final judgment—numerous issues remain to be resolved by the trial court. Thus, appellees do not concede that this Court has jurisdiction over either issue presented by Southland.

A. The Arbitration Clause at Issue Does Not Include, Within Its Scope Statutory Claims Under the California Franchise Investment Law

Southland's preemption argument on the Franchise Investment Law claims cannot be reached unless those claims are within the scope of its standardized arbitration clause—an issue left undecided by the state court.[3] Arbitration is a matter of contract and a party may not be required to arbitrate a dispute it did not agree to arbitrate. *Atkinson v. Sinclair Refining Co.*, 370 U.S. 238, 241 (1962); *Seaboard Coast Line R. Co. v. Trailer Train Co.*, 690 F.2d 1343, 1348 (11th Cir. 1982). Whether the arbitration clause of a contract requires arbitration of a given dispute remains a matter of contract interpretation governed by standard principles of construction. *Atkinson v. Sinclair Refining Co.*, 370 U.S. at 241-242; *Fuller v. Guthrie*, 565 F.2d 259, 260-261 (2d Cir. 1977). The scope of an arbitration clause under the FAA is a question of federal law, *Moses H. Cone Memorial Hospital v. Mercury Constr. Co.*, ... U.S. ...., 103 S.Ct. 927, 941 (1983), just as the scope of an arbitration clause in a collective bargaining agreement is a question of federal law.

In *Iowa Beef Packers, Inc. v. Thompson*, 405 U.S. 228 (1972) (*per curiam*), this Court refused jurisdiction after interpreting the scope of an arbitration clause in a collective-bargaining agreement as being too narrow to include

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[3]It is improper to speak, as Southland does, Op. Br. 6, n. 4, of the California Supreme Court's leaving undisturbed the decision of the court of appeal in this regard. The effect of the supreme court's granting a hearing is to vacate the intermediate decision, which then becomes a nullity, of no force or effect, as though it never existed. *San Diego Gas & Electric Co. v. San Diego*, 450 U.S. 621, 628 (1981), *citing Knouse v. Nimocks*, 8 Cal.2d 482, 483-484, 66 P.2d 438, 438 (1931); *see generally*, 6 B. Witkin, Cal. Procedure, Appeal § 617 (2d Ed. 1971). Having vacated the court of appeal's decision, it left open the question whether the trial court correctly interpreted the clause as being too narrow to encompass the statutory claims. J.S.App. 8a-9a.

the issue presented by the petition for certiorari—whether a statutory claim for overtime wages under the Fair Labor Standards Act was subject to arbitration.[4] In *Leyva v. Certified Growers of California, Ltd.*, 593 F.2d 857 (9th Cir.), *cert. denied*, 444 U.S. 827 (1979), the court, relying in part on *Iowa Beef Packers*, also interpreted an arbitration clause not to include FLSA claims. In construing the contract, it noted that "contracts which provide for arbitration of contract disputes should not be read to require arbitration of statutory claims absent express provision for such arbitration. Here, not only is there no express provision for arbitration of statutory claims, there is . . . a strong indication of contrary intent." *Id.* at 863.

There is good reason for such a rule of construction. Arbitration has traditionally concerned the interpretation and performance of contracts, often in specialized fields, such as collective bargaining or construction contracts. Arbitrators, who are not necessarily lawyers, may be skilled in the particular field, but are not ordinarily expected to interpret and enforce complicated remedial legislation. These considerations have frequently impelled the courts to reject the contention that arbitrators have authority to apply statutory law. " 'The arbitrator has authority to resolve only questions of contractual rights, and this authority remains regardless of whether certain

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[4]The agreement at issue provided for arbitration of grievances "pertaining to a violation of the Agreement." The agreement covered both the employees' lunch period and overtime. The employees brought suit to recover overtime compensation under the Fair Labor Standards Act because they were required to remain on call during their lunch period. The Iowa Supreme Court had held that "the present controversy is undoubtedly arbitrable" under the agreement, but that access to a judicial forum to enforce employee claims under the Act was guaranteed by Congress irrespective of any private agreement to arbitrate. 185 N.W.2d 738, 741 (1971). Here, the California Supreme Court likewise decided the issue as one of statutory interpretation. In each case the question of scope is one which must be decided by this Court preliminary to reaching the issue of statutory interpretation.

contractual rights are similar to, or duplicative of, the substantive rights secured by [the statute].' " *Barrentine v. Arkansas-Best Freight System,* 450 U.S. 728, 744 n. 23 (1981), *quoting Alexander v. Gardner-Denver Co.,* 415 U.S. 36, 53-54 (1974). " 'If an arbitral decision is based "solely upon the arbitrator's view of the requirements of enacted legislation," rather than on an interpretation of the . . . agreement, the arbitrator has "exceeded the scope of the submission," and the award will not be enforced.' " *Id.* at 744, *quoting Steelworkers v. Enterprise Wheel & Car Corp.,* 363 U.S. 593, 597 (1960).

The policy against arbitration of statutory claims in labor cases does not detract from the arbitrator's "high degree of competence with respect to the vital role in implementing the federal policy favoring arbitration of labor disputes." *Alexander v. Gardner-Denver Co.,* 415 U.S. at 57 n. 18. It merely recognizes the arbitrator's limitations. The policy against arbitration of statutory claims applies with even greater force in the context of a commercial dispute under the FAA. In the organized labor context, arbitration is recognized as "part and parcel of the collective bargaining process itself." *United Steelworkers v. Warrior & Gulf Nav. Co.,* 363 U.S. 574, 578 (1960). "Courts and arbitration in the context of most commercial contracts are resorted to because there has been a breakdown in the working relationship of the parties. . . . But the grievance machinery under a collective bargaining agreement is at the very heart of the system of industrial self-government." *Id.* at 581. As a result, this Court has subjected alleged agreements to arbitrate commercial claims involving special statutory safeguards to far greater scrutiny than it generally applies to claims of arbitrability under collective-bargaining agreements. *Id.* at 578.

The FAA affords "an opportunity generally to secure prompt, economical and adequate solution of controversies through arbitration if the parties are willing to accept less

certainty of legally correct adjustment." *Wilko v. Swan*, 346 U.S. 427, 438 (1953). The diversion of such disputes from the courts also helps to relieve court congestion. The very same characteristics which make arbitration highly desirable as the forum of choice for resolution of common law disputes between parties of equal bargaining power make it inappropriate for resolution of important statutory rights of an economically disadvantaged party. See, *Alexander v. Gardner-Denver Co.*, 415 U.S. 36, 57 (1974); *Wilko v. Swan*, 346 U.S. 427, 438 (1953); *Merrill Lynch, Pierce, Fenner & Smith v. Ware*, 414 U.S. 117, 131-32 (1973). Arbitration is essentially a development of the common law which ill-serves the higher standards of protective legislation. *Cf. Herman & MacLean v. Huddleston*, ... U.S. ....., 103 S.Ct. 683 (1983) (rejecting traditional common law practices in establishing standard of proof in actions brought under section 10(b)(5) of the Securities Exchange Act of 1934).

As in the *Leyva* case, the Southland arbitration clause not only contains no express provision for arbitration of statutory claims, but it contains ". . . a strong indication of contrary intent." It begins with a general paragraph which provides that "[*u*]*nless prohibited by applicable law*, any controversy or claim arising out of or relating to this Agreement or the breach hereof shall be settled by arbitration . . . ." J.S. App. 49a n.2. (Italics supplied). This restrictive language does not appear in the standard American Arbitration Association clause, nor has exhaustive research revealed it to be discussed in any reported case. Its presence in the Southland agreement apparently was designed to exclude from arbitration any claims which require a judicial forum under applicable state law, in this case the Calfornia Franchise Investment Law.[5] The Fran-

[5]Southland may argue that it did not have state law in mind. The basic law applicable to the operation of these "Mom and Pop" grocery stores, however, is that of California. Indeed, all of the causes of action are predicated on substantive California law as are all of Southland's defenses. *See* Jt. App. 12-35. Nor can Southland

chise Investment Law claims have little to do with the agreement or its breach. They concern the alleged failure of Southland to comply with statutory disclosure requirements, requirements that apply *before* the parties enter into the franchise agreement. Subsection (i) provides that, "[t]he decision of the arbitrator within the scope of the submission . . . shall be final and binding on all parties, and *any right to judicial action on any matter subject to arbitration hereunder is hereby waived (unless otherwise provided by applicable law). . . .*" *Id.* at 50a n.2 (Italics supplied).

Other provisions of the arbitration clause also support that interpretation. The only remedy the arbitrators are expressly authorized to employ is damages sustained by *breach* of the *agreement. Id.,* Art. 35(g). Subsection (h) provides that, "the arbitrators shall not extend, modify or suspend any of the terms of this Agreement or the reasonable standards of business performance set by 7-Eleven in good faith." *Id.,* Art. 35(h). Thus, while the agreement allows the arbitrator no authority to grant damages other than for breach nor to suspend any terms of the agreement, the Franchise Investment Law specificially requires that plaintiffs be awarded damages caused by Southland's failure to make prepurchase disclosures or, if Southland's failure proves to be willful, recission. Cal. Corp. Code § 31300.[6]

The interaction of these clauses in the agreement leads to the conclusion that subsections (a) and (i) exclude

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reasonably contend that the restrictive language was only intended to exclude nonarbitrable state claims to the extent permitted by the FAA. There were no franchise decisions when these contracts were entered into that held state statutory rights of access to the court preempted by the FAA. Moreover, the scope of the submission is a question of intent. Resort to the FAA only brings the contract interpreter back to the language of the agreement.

[6]"Any person who offers or sells, a franchise in violation of Sections 31101, 31110, 31119, 31200, or 31202, shall be liable to the franchisee or subfranchisor, who may sue for damages caused thereby, and if such violation is willful, the franchisee may also sue

controversies which applicable law reserves to a judicial forum and that in recognition of that intent, subsections (g) and (h) limit the arbitrator's power to the enforcement of the parties' agreement by way of damages for its breach. Under settled rules of contractual interpretation, the specific language of Art. 35(g) operates to modify and nullify what might otherwise be a more general grant of authority contained in Art. 35(a). 3 A. Corbin, Corbin on Contracts § 547, at 176 (1960); *see* Restatement (Second) of Contracts § 203(c).

Southland's failure to include statutory claims within the scope of its arbitration clause precludes the jurisdiction of this Court over the question presented.

B. Southland Did Not Raise Class Arbitration As a Federal Issue in the Court Below

Where " 'the highest state court has failed to pass upon a federal question, it will be assumed that the omission was due to want of proper presentation in the state courts, unless the aggrieved party in this Court can affirmatively show the contrary.' " *Webb v. Webb*, 451 U.S. 493, 495 (1981), *quoting Street v. New York*, 394 U.S. 576, 582 (1969). The appellant must demonstrate that the federal claim and the ground therefor were brought to the attention of the state court with "fair precision and in due time." *New York ex rel. Bryant v. Zimmerman*, 278 U.S. 63, 67 (1928). Only where the record as a whole shows that this was done "either expressly or by clear intendment" is the claim adequately presented. *Id., see Durley v. Mayo*, 351 U.S. 277, 281 (1956).

Southland cannot point to any place in the record where the class arbitration issue was framed in terms of the

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for rescission, unless, in the case of a violation of Section 31200 or 31202, the defendant proves that the plaintiff knew the facts concerning the untruth or omission, or that the defendant exercised reasonable care and did not know, or, if he had exercised reasonable care, would not have known, of the untruth or omission." (Deering's Supp. 1983).

supremacy of federal law. Southland never contended at any level of the state court proceedings that state law was preempted by federal law on the class issue. In contrast to its argument on the Franchise Investment Law issue, Southland's many briefs on this point never used the word preemption or referred to the Supremacy Clause.

In the district court of appeal, Southland was explicitly asked whether federal law controlled the class arbitration issue. Southland responded that the issue was governed by state law.[7] In the supreme court, Southland cited state cases and the lack of state legislative authorization of class arbitration in arguing that California did not permit class arbitration. It repeatedly insisted that federal law apparently permitting the application of the federal class action rules to the FAA was unsound, and that California law, which in its view prohibited a class device, governed the issue.[8] *See* discussion in Motion to Dismiss at 5-6.

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[7]The clerk of the state court of appeal specifically asked the parties to address the question "[w]hether there can be arbitration of the class action. Please address the applicability, if any, of the California Code of Civil Procedure section 1281.3 and Federal Rules of Civil Procedure 81(a) and 23. Indicate in your answer *whether state* or *federal* law *applies* and the reason for your choice of law." (Italics supplied). Southland responded that California law applied. Supplemental Memorandum of Points & Authorities in Opposition to Petition for Writs of Mandate or Prohibition and Appellants' Reply Brief at 19-25.

[8]In the supreme court, Southland characterized the court of appeal's analogy to the application of Federal Rules of Civil Procedure 23 and 42 to arbitration proceedings under the FAA as "unsound." As Southland stated: "In the first place the Federal Rules of Civil Procedure are not applicable here. Under the *Erie* doctrine, state courts normally apply their own procedural rules in litigation involving a federal substantive right, provided such application does not impair the federal right. And under California law, there is an express statutory basis for *consolidating* separate arbitration claims, but there is no basis—statutory or otherwise—for compelling class action arbitration." Southland's Petition for Hearing at 24-25 (Italics in original). Thus, Southland expressly

As a result, the state courts decided the issue solely in terms of state law. An argument initially presented to the state courts in terms of state law cannot be shifted into a constitutional argument in order to gain review in this Court. 16 C. Wright & A. Miller, Federal Practice and Procedure § 4022 at 703 (1977); *see Bailey v. Anderson*, 326 U.S. 203, 205-207 (1945). Accordingly, Southland fails to meet the jurisdictional requirement that the federal issue be properly presented to the state courts.

C. There Is No Final Judgment

The final judgment rule serves to minimize federal intrusion in state affairs. *North Dakota Pharmacy Board v. Snyder's Stores*, 414 U.S. 156, 159 (1973). As Southland acknowledges, the decision below is not a final judgment conclusively determining the issues in the case. There will be further state court proceedings. Southland argues, however, that this case fits within that narrow category of exceptions allowing review of final determinations of federal issues which might "seriously erode" federal policy. *Cox Broadcasting Corp. v. Cohn*, 420 U.S. 469 (1975).[9]

These exceptions arose where the order appealed from was not subject to further modification or review. Where, however, the issues presented are unsettled, the case should be dismissed for lack of a final judgment. In

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negated any federal issue; rather, it relied upon the absence of any California authority for such a procedure. Indeed, in its reply brief before the supreme court, Southland argued that a class arbitration would be appropriate if there "were a serious and well-recognized need for class actions in this setting. But no such need has been identified by the *legislature*, by the courts, by the American Arbitration Association, or in the legal literature." Southland's Reply Brief in Answer to Petition for Hearing at 17. (Italics supplied). This is a clear reference to the California Legislature, not Congress.

[9] *Cohen v. Beneficial Industrial Loan Corp.*, 337 U.S. 541 (1949), relied upon by Southland, has generally not been applied to cases arising under 28 U.S.C. § 1257. *But see, National Socialist Party v. Village of Skokie*, 432 U.S. 43 (1977).

Gillette v. Miner, ... U.S. ....., 103 S.Ct. 484 (1982), the petition for certiorari sought review of a state supreme court's remand to a trial court for consideration of certification of a nationwide class. In the proceedings below, the petitioner had argued that due process considerations precluded a nationwide class. The Illinois Supreme Court rejected petitioners' arguments and remanded for class certification proceedings. *See* 87 Ill. 2d 7, 428 N.E. 2d 478 (1981). This Court dismissed the petition for certiorari for lack of a final judgment.

Here, in contrast to *Cox*, further proceedings will occur which may very well change the complexion of the issues before this Court. As in *Gillette*, the California Supreme Court reversed the trial court's order and remanded for further consideration. The trial court had refused to conduct class certification proceedings before arbitration of plaintiffs' common law claims and had stayed litigation of plaintiffs' nonarbitrable statutory claims until the outcome of such arbitration. *See* J.S.App. 29a. The trial court must now decide whether the franchisees are a proper class, and if so, whether a class arbitration can be fashioned that will protect the class from the otherwise unconscionable effect of an arbitration clause placed in a standardized contract of adhesion. If the class cannot be protected, the whole arbitration clause may fall.[10] Moreover, since the

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[10]The validity of an arbitration agreement, as opposed to its scope, is a question of state law. *See, e.g., Supak & Sons Mfg. Co., Inc. v. Pervel Industries, Inc.*, 593 F.2d 135, 136-37 (4th Cir. 1979); *American Airlines, Inc. v. Louisville & Jefferson C.A.B.*, 269 F.2d 811, 816 (6th Cir. 1959); *Duplan Corp., etc. v. W. B. Davis Hosiery Mills*, 442 F.Supp. 86, 88 (S.D.N.Y. 1977). The California Supreme Court could have invalidated the arbitration clause under general contract principles because it was unconscionable and defeated the reasonable expectations of the nondrafting party if it blocked an otherwise appropriate class action. The court chose not to do so, however, because it viewed the class arbitration as providing the opportunity to redress classwide wrongs. J.S.App. 24a-26a.

common law claims may be arbitrable and the statutory claims are not, the trial court may decide that the interests of justice are best served by resolving the entire dispute in court, whether or not there is a class.[11] Absent such a determination, it must still decide which will proceed first—the arbitration or the court action.[12] It may decide that consolidation, which Southland asserts is an unsettled federal issue, may be proper; still other permutations may become apparent upon further proceedings below.

As a separate basis for urging that the class arbitration issue is final, Southland contends that it is appealing from the final disposition of an independent proceeding for a writ of prohibition. Thus, it argues a final judgment exists because a writ proceeding automatically results in such a judgment. Op. Br. 18 & n. 18.[13] This description mis-

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[11]When the presence of nonarbitrable claims prevents arbitration of the dispute as a whole, both federal and state courts have discretion to deny arbitration in order to prevent piecemeal, "inefficient and duplicative" resolution of claims or, more realistically, to avoid presenting plaintiffs with the Hobson's choice of dropping their common law claims to speed collection on their statutory claims or dropping their lawsuit "hoping for faster and cheaper results through arbitration." *Cunningham v. Dean Witter Reynolds*, 550 F.Supp. 578, 582, 584 n. 7 (E.D. Cal. 1982); *see Hope v. Superior Court*, 122 Cal.App.3d 147, 155, 175 Cal.Rptr. 851, 856-857 (1981), *cert. denied*, ... U.S. ...., 102 S.Ct. 1760 (1982).

[12]*See, e.g., Bos Material Handling, Inc. v. Crown Controls Corp.*, 137 Cal.App.3d 99, 111-12, 186 Cal.Rptr. 740, 747 (1982); *Sibley v. Tandy Corp.*, 543 F.2d 540, 543-544 (5th Cir. 1976), *rehearing denied*, 547 F.2d 286, *cert. denied*, 434 U.S. 824 (1977); *Dickenson v. Heinold Securities, Inc.*, 661 F.2d 638, 643-645 (7th Cir. 1981).

[13]In each of the cases cited by Southland for the proposition that a writ proceeding always results in a final judgment, Op. Br. 18, the party appealing to this Court was aggrieved by the denial of that party's claim that the lower courts were without jurisdiction to proceed. Here, Southland was aggrieved not by the denial of

characterizes the disposition of the issue by the California Supreme Court.

Southland's appeal from the trial court's initial order denying arbitration on the Franchise Investment Law claims had the effect of giving the state's appellate courts jurisdiction over all aspects of that order, including the order sending the common law claims to individual arbitration. *See* Cal. Civ. Proc. Code § 1294.2.[14] Therefore, the state supreme court had no need to, and did not, exercise its original jurisdiction under the writ to consider the class arbitration issue. Plaintiffs' petition for a writ of mandate or prohibition was denied.

As Southland recognizes, this Court compels a "practical" rather than mechanical approach to the question of finality. Op. Br. 12, 20. The fact that a decision below is rendered in connection with a writ proceeding is not dispositive of the issue of finality. *See Runyan v. California*, 439 U.S. 904 (1978) (appeal from order granting writ of prohibition dis-

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the writ of prohibition, which was the result it sought, but rather by the reversal of the order compelling individual arbitrations to proceed immediately on the common law claims. It is that reversal from which Southland now appeals.

[14]"The appeal shall be taken in the same manner as an appeal from an order or judgment in a civil action. Upon an appeal from any order or judgment under this title, the court may review the decision and any intermediate ruling, proceeding, order or decision which involves the merits or necessarily affects the order or judgment appealed from, or which substantially affects the rights of a party. The court may also on such appeal review any order on motion for a new trial. The respondent on the appeal, or party in whose favor the judgment or order was given may, without appealing from such judgment, request the court to and it may review any of the foregoing matters for the purpose of determining whether or not the appellant was prejudiced by the error or errors upon which he relies for reversal or modification of the judgment or order from which the appeal is taken. The provisions of this section do not authorize the court to review any decision or order from which an appeal might have been taken." Cal. Civ. Proc. Code § 1294.2.

missed for lack of final judgment). Such a practical approach is especially counseled here where further proceedings on these issues will definitely occur.

Moreover, neither issue presented by Southland raises federal questions which require immediate review because they might seriously erode federal policy, *Cox Broadcasting Corp v. Cohn, supra,* 420 U.S. at 483; both are matters limited to state concerns and state court dockets. Southland pins its claim to jurisdiction on the FAA, but that Act does not reach the issues presented. State protective legislation, such as the Franchise Investment Law, was never intended to, and does not, fall within the coverage of the Act. *See infra* at 22-27. Thus, there can be no serious erosion of a federal policy demanding immediate review before this Court.

Similarly, the class arbitration issue does not erode federal policy. The FAA does not usurp local court procedures which merely go to the method of enforcing arbitration.[15] The decision below favors arbitration even in the context of an adhesion contract by adopting a state court procedure calculated to reconcile arbitration and class actions. This procedure is solely a matter of local concern governing how the California courts should enforce arbitration in a particular type of adhesion contract.

Southland concedes that its appeal does not fit within traditional definitions of a final judgment. It thus attempts to fit the narrow exceptions defined in *Cox*. For the reasons stated above, the issues presented do not meet the criteria of these exceptional categories and, accordingly, there is no final judgment.

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[15] *See* discussion *infra* at 42-43.

II

THE FEDERAL ARBITRATION ACT DOES NOT AFFECT THE RIGHT OF A STATE TO SPECIFY A JUDICIAL FORUM FOR RESOLUTION OF STATUTORY CLAIMS*

The FAA was enacted to allow the federal courts to place arbitration agreements on the same footing as other contracts. Most of the states, including California, have adopted similar modern arbitration acts.[16] The FAA and parallel state acts merely permit parties to enforce predispute arbitration agreements. These acts were not intended to confer upon the parties to arbitration agreements the authority to override the states' traditional power to regulate the conduct of businesses operating within their borders.

This proposition is particularly true in the area of investor protection. Following the pattern set by federal prepurchase disclosure laws in the area of securities regulation, the California Legislature enacted the California Corporate Securities Law and the Franchise Investment Law. Both preserve an investor's access to the courts to ensure their effectiveness. J.S.App. 16a-17a.

Southland does not dispute the California Legislature's power to enact substantive law in these areas, or the enforceability of the right to a judicial forum for statutory claims involving purely intrastate disputes. But the reality of today is that almost everything affects interstate commerce. Thus, Southland asks this Court to destroy the effectiveness of California's (and other states') remedial legis-

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*The North American Securities Administrators Association, Inc. ("NASAA") has asked appellees to advise the Court that it joins in this part of the brief. NASAA is a regulatory association of securities regulators, including regulators from all 50 states.

[16]As of January 1, 1982, 42 states and the District of Columbia had adopted modern arbitration statutes. *See* Motion to Dismiss at 18 n. 14.

lation by declaring private agreements paramount to such laws. The state judiciary would be stripped of its constitutional duty to safeguard the statutory rights of investors whenever interstate franchisors have the foresight to place arbitration provisions in their standardized contracts. Fortunately, judicial extension of section 2 of the FAA to actions in state court does not entail such a harsh and illogical consequence. The Act simply does not delegate to private parties the power to control the forum for enforcement of important statutory rights.

A. An Intent to Preempt Cannot Be Inferred Where It Would Cripple the Exercise of State Police Power in a Substantive Area in Which Congress Has Intended State Law to Operate Vigorously

"[W]hen a State's exercise of police power is challenged under the Supremacy Clause, '[this Court] start[s] with the assumption that the historic police powers of the States [are] not to be superseded by [federal statutes] unless that was the *clear and manifest* purpose of Congress." *Ray v. Atlantic Richfield Co.*, 435 U.S. 151, 157 (1978) (italics supplied). Preemption is the exception, not the rule.[17] When respective federal and state sovereignties are juxtaposed, "the proper approach is to reconcile 'the operation of both statutory schemes with one another rather than holding one completely ousted.'" *Merrill Lynch, Pierce, Fenner & Smith v. Ware*, 414 U.S. 117, 127 (1973) (citations omitted). "[F]ederal regulation of a field of commerce should not be deemed preemptive of state regulatory power in the absence of persuasive reasons—either that the nature of the regulated subject matter permits no other conclusion, or that the Congress has unmistakably so ordained." *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142 (1963).

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[17]Even in areas of strong national concern, this Court is loath to find a congressional intent to preempt state regulation absent explicit preemptive language. *See, e.g., Pacific Gas & Elec. Co. v. State Energy Resources Cons. & Dev. Comm.*, ... U.S. ...., 103 S.Ct. 1713 (1983).

"[While] prior cases on preemption are not precise guidelines, [because] each case turns on the peculiarities and special features of the federal regulatory scheme in question,"[18] the *Ware* case presents a preemption issue very similar to the one here. The plaintiff, a former account executive, brought a class action in the California courts to recover benefits of a profit sharing plan forfeited upon termination of employment. The question presented to this Court was whether New York Stock Exchange Rule 347(b), requiring arbitration of all claims arising out of Exchange members' employment contracts, preempted California Labor Code provisions ensuring a judicial forum for wage claims. This Court, in a unanimous opinion (Stewart, J., not participating), held that California's strong policy in favor of providing a judicial forum for wage claims did not unduly burden interstate commerce or interfere with the fulfillment of the aims of the Securities Exchange Act. This Court further noted that California had a strong interest in protecting nonunionized wage earners from "what it regards as undesirable economic pressures affecting the employment relationship." 414 U.S. at 139.

In *Ware*, this Court concluded that congressional permission to establish the stock exchange's rule compelling arbitration was not intended to override otherwise applicable state law. The FAA is similar. It does not require arbitration of commercial disputes in interstate commerce; the Act merely permits the enforcement of otherwise valid agreements to arbitrate.[19] Indeed, the federal interest here

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[18] *City of Burbank v. Lockheed Air Terminal, Inc.*, 411 U.S. 624, 638-639 (1973).

[19] In enacting the Arbitration Act, unlike various other statutes invoking the interstate commerce power, Congress was not seeking to regulate and control activity affecting commerce, but was providing for those engaged in interstate transactions an expeditious extrajudicial process for settling disputes. The Arbitration Act may be avoided entirely by those engaged in interstate traffic if they merely refrain from including any arbitration provisions in their contracts." *Metro Industrial Painting Corp. v. Terminal Constr. Co.*, 287 F.2d 382, 387 (2d Cir. 1961) (Lumbard, C.J., concurring).

is less strong than in *Ware*. There, arbitration was pursuant to a Stock Exchange rule promulgated as part of a scheme for the self-regulation of an entire industry. The FAA is of general application. It does not purport to encroach upon the police powers of the state in any substantive field.[20]

Franchise investor regulation is not a field which Congress has preempted by pervasive federal regulation as it has a field such as organized labor relations. J.S.App. 17a.[21] Franchise regulation is an offshoot of securities regulation where state policies are expected to operate vigorously. *Merrill Lynch, Pierce, Fenner & Smith v. Ware, supra,* 414 U.S. at 140. In 1972, the California Legislature reacted to widespread abuse in the sale of California franchises by enacting a prepurchase disclosure law modeled after the 1933 Securities Act. J.S.App. 10a. Like the federal act, it was designed to remedy the disadvantages under which prospective purchasers labored in investigating and evaluating prospective earnings, and thus created a cause of action independent of the common law. *See* Cal. Corp. Code § 31001;[22] *Wilko v. Swan,* 346 U.S. 427, 435 (1953). Like

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[20]Congressional prohibition of the exercise of state police power in favor of the free play of economic forces can only be inferred where there is a comprehensive federal scheme encompassing the subject matter. *Machinists v. Wisconsin Employment Relations Comm'n.*, 427 U.S. 132, 140 (1976); *Teamsters Local 20 v. Morton,* 377 U.S. 252, 260 (1964).

[21]Indeed, even the "comprehensive amalgam of substantive law and regulatory arrangements that Congress set up in the NLRA" does not preempt any and all state causes of action involving the same subject matter. This Court repeatedly has upheld state causes of action against a claim that they were preempted by the NLRA, "[w]hen the conduct at issue is only a peripheral concern of the Act or touches on interests . . . deeply rooted in local feeling and responsibility." *Local 926 v. Jones,* .... U.S. ...., 103 S.Ct. 1453, 1459 (1983) and cases cited therein.

[22]"The Legislature hereby finds and declares that the widespread sale of franchises is a relatively new form of business which has created numerous problems both from an investment and a business point of view in the State of California. . . . California franchisees

that Act, it created a nonwaivable private right of action. J.S.App. 9a-13a.

Just as the general federal policy favoring arbitration has not prevented Congress from including an antiwaiver provision in federal investor protection legislation, California's general policy favoring arbitration has not prevented the California Legislature from including an antiwaiver provision in state investor protection legislation. That a different result should be compelled because the antiwaiver provision applies to a contract affecting interstate commerce makes no sense. As the California Supreme Court observed, "[h]aving left states with power to enact laws in this area, it is hardly likely that Congress intended to preclude them from adopting policies which Congress itself has found to be appropriate." J.S.App. 17a. Nothing in the history or purpose of the FAA suggests a congressional intent to treat state remedial legislation on a different footing from federal remedial legislation.

B. Congress Did Not Intend to Include Either State or Federal Statutory Claims Within the Coverage of the Act

With any consideration of statutory construction, consideration "begins, as indeed it must, with the text and legislative history . . . ." *Busic v. United States*, 446 U.S. 398, 405 (1980).

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have suffered substantial losses where the franchisor or his representative has not provided full and complete information regarding the franchisor-franchisee relationship, the details of the contract between franchisor and franchisee, and the prior business experience of the franchisor.

It is the intent of this law to provide each prospective franchisee with the information necessary to make an intelligent decision regarding franchises being offered. Further, it is the intent of this law to prohibit the sale of franchises where such sale would lead to fraud or a likelihood that the franchisor's promises would not be fulfilled, and to protect the franchisor by providing a better understanding of the relationship between the franchisor and franchisee with regard to their business relationship."

The record is clear that Congress intended the FAA merely to overcome traditional judicial hostility to arbitration by placing such agreements "upon the same footing as other contracts" in the federal courts. H.R.Rep. No. 96, 68th Cong., 1st Sess. 1 (1924). It did not involve any new principle of law or create any new rights.[23] The Act provides a procedural device[24] in "the courts of the United States" applicable to "any maritime transaction or a contract evidencing a transaction involving commerce." 9 U.S.C. §§ 2, 3.

Congress acted primarily under its powers to "prescribe how federal courts are to conduct themselves with respect to subject matter over which Congress plainly has power to legislate." *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 405 (1967). The Act was plainly not intended to impose any restrictions on the states.[25]

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[23]In explaining the bill in the House of Representatives, one of its proponents stated:

> "This bill simply provides for one thing, and that is to give an opportunity to enforce an agreement in commercial contracts and admiralty contracts—an agreement to arbitrate, when voluntarily placed in the document by the parties to it. It does not involve any new principle of law except to provide a simple method by which the parties may be brought before the court in order to give enforcement to that to which they have already agreed. . . . It creates no new legislation, grants no new rights, except a remedy to enforce an agreement in commercial contracts and in admiralty contracts." 65 *Cong. Rec.* 1,931 (1924) (Rep. Graham, Pa.)

[24]"A Federal statute providing for the enforcement of arbitration agreements does relate solely to procedure of the Federal courts. It is no infringement upon the right of each state to decide for itself what contract shall or shall not exist." 11 A.B.A.J. 153, 154 (1925).

[25]As explained by the drafters in addressing the 1924 Congress: "[t]he theory on which you do this is that you have the right to tell the federal courts how to proceed." Joint Hearings on S. 1005 and H.R. 646 Before the Subcomms. of the Comms. on the Judi-

It was not until 35 years after passage of the Act that the courts developed the concept that there were certain substantive aspects to the FAA applicable in state as well as federal courts. *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*, 271 F.2d 402 (2d Cir. 1959), *cert. denied*, 364 U.S. 801 (1960). This judicial finding that the Act contained substantive aspects resulted from a perception that the *Erie* doctrine would prohibit the federal courts from applying the Act in diversity cases.[26] Nevertheless, one of the justices who decided *Robert Lawrence* counseled that caution must be exercised so as to construe this intrusion upon state sovereignty as narrowly as possible:

> [T]he legislative history of the Arbitration Act of 1925 reveals little awareness on the part of Congress that state law might be affected . . . . Having no clear mandate from Congress as to the extent to which state statutes and decisions are to be superseded, we must be cautious in construing the act lest we excessively encroach on the powers which Congressional policy, if not the Constitution, would reserve to the states.

Metro Industrial Painting Corp. v. Terminal Constr. Co., 287 F.2d 382, 386 (2d Cir. 1961) (Lumbard, C. J., concurring).

In *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, ... U.S. ....., 103 S.Ct. 927 (1983), this

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ciary, 68th Cong., 1st Sess. 17 (1924), Statement of Julius Cohen. "Nor can it be said that the Congress of the United States, directing its own courts . . . , would infringe upon the provinces or prerogatives of the States. . . . [T]he question of enforcement relates to the law of remedies and not to substantive law. The rule must be changed for the jurisdiction in which the agreement is sought to be enforced . . . . *There is no disposition therefore by means of the Federal bludgeon to force an individual State into an unwilling submission to arbitration enforcement.*" *Id.* at 39-40 (italics supplied).

[26] *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*, *supra*, 271 F.2d 402, 404-409.

Court has now declared, "The effect of [section 2] is to create a body of federal substantive law of arbitrability, applicable to any arbitration agreement *within the coverage of the Act.*" *Id.*, at ....., 103 S.Ct. at 941 (italics supplied). That case, like *Prima Paint* and *Robert Lawrence*, dealt solely with a common law dispute, not one involving a remedial statute.

In the present case, the California Supreme Court applied section 2 of the FAA to plaintiffs' common law claims since the agreement to arbitrate such claims fell "within the coverage of the Act." A separate issue, which this Court has never addressed,[27] was raised as to the arbitrability of plaintiffs' statutory claims—claims which Congress plainly never envisioned to be "within the coverage of the Act."

The drafters of the FAA expected the Act to apply solely to ordinary contract disputes "between merchants as to questions of fact—quantity, quality, time of delivery, compliance with terms of payment, excuses for nonperformance, and the like," involving simple issues of law. Cohen & Dayton, *The New Federal Arbitration Law*, 12 Va.L.Rev. 265, 281 (1926). "[*Arbitration*] *is not the proper method of deciding points of law of major importance involving constitutional questions or policy in the application of statutes.*" *Id.* (italics supplied).

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[27] Although the petitioner in *Ware* argued that the FAA also preempted the California Labor Code, Brief for Petitioner at 25-27, this Court did not reach that question and decided only that the Exchange's self-governing provisions promulgated pursuant to 15 U.S.C. § 78 did not preempt the California statute. Why this issue was not reached is unclear. *See* discussion in Motion to Dismiss at 23-24. The most likely explanation is that this Court concluded that application of the FAA would not have affected the preemption analysis. *See Muh v. Newburger, Loeb & Co.*, 540 F.2d 970, 973 (9th Cir. 1976), where the court assumed that *Ware* applied with equal force to an argument that California Labor Code section 229 was preempted by the FAA. Arbitration was nonetheless compelled in *Muh* because the plaintiff did not have a true wage claim under the California statute.

Thus, the drafters themselves recognized that arbitration is not a suitable means for dealing with important statutory rights. In *Alexander v. Gardner-Denver Co.*, 415 U.S. 36 (1974), this Court made the same observation in unanimously upholding an employee's right to litigate employment discrimination claims under Title VII of the Civil Rights Act of 1964 after unsuccessfully arbitrating the same set of facts as a contract claim under a collective bargaining agreement. "Both rights have legally independent origins and are equally available to the aggrieved employee." *Id.* at 52. This Court went on to explain: "Parties usually choose an arbitrator because they trust his knowledge and judgment concerning the demands and norms of industrial relations. On the other hand, the resolution of statutory or constitutional issues is a primary responsibility of courts. . . ." *Id.* at 57.

Over the years, this Court and the lower federal courts have recognized the need for a judicial forum to ensure full scrutiny of a variety of important rights which also happen to rest on operative facts ostensibly arbitrable under a contract.[28] These decisions recognize the unsuit-

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[28] *See, e.g., U.S. Bulk Carriers v. Arguelles*, 400 U.S. 351 (1971) (seaman's wage claim under 46 U.S.C. § 596 *et seq.* nonarbitrable); *Barrentine v. Arkansas-Best Freight System*, 450 U.S. 728 (1981) (claim for minimum wages under FLSA nonarbitrable); *Merrill Lynch, Pierce, Fenner & Smith v. Moore*, 590 F.2d 823 (10th Cir. 1978) (claims under Securities Act of 1933 and Securities Exchange Act of 1934 nonarbitrable); *Allegaert v. Perot*, 548 F.2d 432 (2d Cir.), *cert. denied* 432 U.S. 910 (1977) (claims brought against trustee in bankruptcy nonarbitrable); *American Safety Equipment Corp. v. J. P. Maguire & Co.*, 391 F.2d 821 (2d Cir. 1968) (claims brought under Sherman Antitrust Act nonarbitrable); *A & E Plastik Pak Co. v. Monsanto Co.*, 396 F.2d 710 (9th Cir. 1968) (same); *Curran v. Merrill Lynch, Pierce, Fenner & Smith*, 622 F.2d 216 (6th Cir. 1980) *aff'd* .... U.S. ...., 102 S.Ct. 1825 (1982) (claims brought uder Commodity Exchange Act nonarbitrable except in certain limited circumstances); *Breyer v. First National Monetary Corp.*, 548 F.Supp. 955 (D.N.J. 1982) (same); *Horne v. New England Patriots Football Club*, 489 F.Supp. 465 (D.Mass. 1980) (age discrimination claims brought under 29 U.S.C. § 621 non-

ability of arbitration as a means of resolving important statutory rights which are imbued with a public, and not just private, interest—an observation first made by this Court in *Wilko v. Swan*, 346 U.S. 417, 435-437 (1953).

There is no question that the decision of claims by arbitrators rather than the courts radically affects a cause of action. It removes numerous guarantees available to litigants in a court of law as a trade-off for parties seeking an informal resolution of private disputes. *Id.* at 435-438; *Bernhardt v. Polygraphic Co. of America*, 350 U.S. 198, 203 (1956); *Alexander v. Gardner-Denver Co., supra*, 415 U.S. at 57. This is why a predispute arbitration agreement between parties of unequal bargaining power has generally been held unenforceable under federal law wherever important rights are involved. That same advance trade-off is just as unacceptable where important state-created rights are concerned.

C. Parallel State Arbitration Acts Also Exclude from Arbitration Important Statutory Claims for which Access to the Courts Is Deemed Essential

The Federal Arbitration Act of 1924 was modeled after the New York arbitration law. Under New York law, [a]lthough arbitration is a favored method of dispute resolution, arbitration agreements are unenforceable where substantive rights, embodied by statute, express a strong public policy which must be judicially enforced." *In re Wertheim & Co., Inc. v. Halpert*, 48 N.Y.2d 681, 683, 397 N.E.2d 386, 387, 421 N.Y.S.2d 876, 877 (1979). *See* cases cited at J.S.App. 16a. California was also among the earliest states to adopt a modern arbitration statute. Now

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arbitrable). Until recently, courts had also interpreted the patent and trademark laws as requiring judicial enforcement—a practice which was consistent with prior law but which has now been superseded by congressional directive in enacting the patent and trademark appropriations bill for 1983-85. Pub. L. No. 97-247 (1982). Significantly, Congress has left untouched the judicial construction of its intent in the area of securities litigation, bankruptcy and antitrust.

the vast majority of the states have enacted similar legislation.

The state courts have followed the same reasoning as the federal courts in determining whether to enforce arbitration agreements arising under their own statutory schemes. They first determine whether the arbitration agreement is valid under general principles of contract law. Then they look to whether the claim arose from the common law and is covered by the liberal policy favoring arbitration or, if a statutory claim, whether the state legislature intended its enforcement to be reserved to the courts.[29] When the Federal Arbitration Act assertedly applies, the analysis should be the same.[30] Thus, the crucial question is whether the state legislature made access to a judicial forum essential to the enforcement of the particular legislation in question.

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[29]*See, e.g., Kiehne v. Purdy*, 309 N.W.2d 60 (Minn. 1981) (state securities law claims not arbitrable), *Sandefer v. Reynolds Securities Inc.*, 618 P.2d 690 (Colo.App. 1980) (same); *United Nuclear Corp. v. General Atomic Co.*, 93 N.M. 105, 597 P.2d 290, *cert. denied*, 444 U.S. 911 (1979) (state antitrust law claim not arbitrable); *Aimcee Wholesale Corp. v. Tomar Products Inc.*, 21 N.Y.2d 621, 237 N.E.2d 223, 289 N.Y.S.2d 968 (1968) (same); *Bos Material Handling, Inc. v. Crown Controls Corp.*, 137 Cal.App.3d 99, 186 Cal.Rptr. 740 (1982) (same); *Durst v. Abrash*, 22 A.D.2d 39, 253 N.Y.S.2d 351 (1964) (issue of whether transaction was disguised usurious loan not arbitrable).

[30]Differences still exist between state and federal law. In cases involving common law claims in interstate commerce where the state policy is not strong, the federal policy favoring arbitration under the FAA prevails. *See* cases cited in Motion to Dismiss at 18-19. There are also a few states still holding the FAA inapplicable in state court. *See Thayer v. American Financial Advisers, Inc.*, 322 N.W.2d 599 (Minn. 1982). Although *Moses H. Cone Memorial Hospital* would now render the FAA applicable, the outcome in *Thayer* would not necessarily change. This is because Thayer's primary claims arose under the Commodity Exchange Act. *See Milani v. Conti Commodity Services, Inc.*, 462 F.Supp. 405 (N.D.Cal. 1976) (refusing to compel arbitration of state law claims arising out of the same transaction as nonarbitrable claims under the Commodity Exchange Act).

In *Allison v. Medicab International, Inc.*, 92 Wash.2d 199, 597 P.2d 380 (1979), cited by Southland, the court found insufficient evidence of a legislative intent to void predispute arbitration agreements under Washington's franchise law. The possibility of preemption was advanced as a further reason to infer that the legislature did not intend to void such agreements. Southland mistakenly relies on this decision as supporting its position that the FAA utterly prevents state legislatures from voiding advance agreements to arbitrate statutory claims. It does not. Where a legislative intent to void predispute agreements under Washington's Consumer Protection Act was found, the Washington appellate court proceeded to uphold the legislation in the face of a claim that it was preempted by the FAA. *Wineland v. Marketex Intern. Inc.*, 28 Wash. App. 830, 627 P.2d 967 (1981).

Missouri likewise enforces the FAA with respect to common law claims. *State ex rel. St. Joseph Light & Power Co. v. Donelson*, 631 S.W.2d 887 (Mo.App. 1982), but has refused to order arbitration requested under both federal and state arbitration acts where violations of state securities laws were alleged because of Missouri's "very strong policy in favor of providing a judicial forum for the claims of investors under the blue sky laws." *State Ex. Rel. Geil v. Corcoran*, 623 S.W.2d 557, 559 (Mo.App. 1981).

This Court applied a similar analysis in reviewing the state wage law in *Ware*. It noted that the California Legislature "had in mind the rights accorded wage earners by § 229" as well as the "historical friendliness of California to the institution of arbitration" when it revised the California Arbitration Act. Section 229 survived subsequent legislative review and manifested itself as an important state policy. 414 U.S. 117, 132-133. This Court concluded that the California Legislature felt that "individual, nonunion, and otherwise unprotected" wage earners would receive "less than adequate protection" if relegated to arbitration. *Id.* at 131.

Similar legislative concern for preservation of access to the courts evidences itself in the antiwaiver provisions of the California Franchise Investment Law and the California Corporate Securities Law, Cal. Corp. Code §§ 31512, 25701,[31] patterned after antiwaiver provisions in the federal securities laws. J.S. pp. 16a-17a & n.13. The antiwaiver provision of the California Franchise Investment Law, like Labor Code section 229, has gone through subsequent legislative scrutiny and also emerged as an important state policy through interpretation by the California courts. J.S. App. 11a-13a.[32]

Southland cannot reargue here the California Supreme Court's conclusion that the California Legislature intended its use of the antiwaiver language of the 1933 Securities Act to be given the same interpretation as the federal law was given in *Wilko*. That is purely a question of state law beyond the scope of review by this Court. *Ware, supra,* 414 U.S. 117, 133 (1973). Nor does it argue that the FAA has been judicially construed to encompass federal statutory claims as well as contractual claims. Rather, it contends that the application of the supremacy clause provides a Catch-22 which prevents states from adopting a legislative scheme, parallel to that of Congress, whenever interstate commerce is affected by state protective legislation.[33]

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[31]Cal.Corp.Code § 31512 is set forth in Op.Br. at 3. Cal.Corp. Code § 25701 provides: "Any condition, stipulation or provision purporting to bind any person acquiring any security to waive compliance with any provision of this law or any rule or order hereunder is void."

[32]Indeed, similar concerns have led various states enacting protective legislation to borrow the identical antiwaiver language in *Wilko* to ensure that there would be no mistake about their intent to prescribe a judicial forum for resolution of the claims they were creating. *See* Motion to Dismiss at 15 n. 8.

[33]The Federal district court cases cited by Southland in support of this proposition are of no persuasive value. The principal ones arose out of Wisconsin—*Romnes v. Bache & Co.*, 439 F.Supp. 833 (W.D. Wis. 1977) and *Barron v. Tastee Freez International, Inc.*, 482 F.Supp. 1213 (E.D. Wis. 1980) both decided by Judge Reyn-

D. The Federal Arbitration Act Defers to State Law on Issues of Validity such as the Antiwaiver Provision of the Franchise Investment Law

Section 2 of the Act requires courts to look to state contract laws to determine the validity of arbitration agreements within the ambit of the Act. *American Airlines, Inc. v. Louisville & Jefferson C.A.B.*, 269 F.2d 811, 816 (6th Cir. 1959); *Supak & Sons Mfg. Co. v. Pervel Industries, Inc.*, 593 F.2d 135, 136-37 (4th Cir. 1979). The liberal federal policy behind section 2, like that of California Code of Civil Procedure Section 1281, only comes into play *after* a valid agreement to arbitrate has been found under applicable state law. "By its terms, § 2 does not apply until the arbitration clause in question is determined to be part of the contract. Section 2 dictates the *effect* of a contractually agreed-upon arbitration provision, but it does not displace state law on the general principles governing *formation* of the contract itself." *Supak & Sons Mfg. Co., Inc. v. Pervel Industries, Inc., supra*, 593 F.2d at 137 (italics supplied). Thus, the Act has been construed to defer to state law on the parties' capacity[34] on the issues of fraud or undue in-

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olds, and *Bache Halsey Stuart Shields, Inc. v. Moebius*, 531 F.Supp. 75 (E.D. Wis. 1982) decided by Judge Gordon. *See* discussion Motion to Dismiss at 16 n. 10. *Romnes* involved claims under the Commodity Exchange Act which has been interpreted to bar similar advance agreements to arbitrate. *See, supra*, at 27-28 nn. 28 & 30. *Moebius* involved an employment dispute nonarbitrable under Wisconsin law. The issue in *Moebius* may well have been governed by this Court's analysis in *Ware*, the applicability of which was apparently not raised by the parties. *Barron* involved the interaction between antiwaiver provisions in the Wisconsin and Illinois franchise investment acts and the FAA. The decision was devoid of any reasoning in support of the judge's conclusion that he was "compelled" under principles of preemption "to render void any effort made by a state to protect the remedies of franchise investors. . . ." 482 F.Supp. at 1217.

[34] *American Airlines, Inc. v. Louisville & Jefferson C.A.B.*, 269 F.2d 811 (6th Cir. 1959) (holding that Kentucky law controlled the question of the capacity of a municipal corporation to enter into an arbitration agreement).

fluence in the inducement[35] and other issues of contract formation.

No contract is valid if it is unlawful. The specific law applicable here is the California Franchise Investment Law, a statutory scheme designed in large part to combat franchisor fraud. *See* Cal.Corp.Code § 31001, *supra* at 21-22 n. 22. Any provision in a franchise contract which purports to waive compliance with any provision of the Franchise Investment Law is void. Cal. Corp. Code § 31512. In the state courts Southland argued that the antiwaiver statute was not intended to have any effect upon agreements to arbitrate statutory claims.[36] Now it contends that the statute is anti-arbitration. Neither is true. The Franchise Investment Law requires access to a judicial forum for vindication of the rights which it provides franchise investors. An agreement to arbitrate future disputes under the Franchise Investment Law has been definitively construed as a prohibited waiver of that statutory provision. This rule does not treat arbitration agreements differently from any other contracts which purport to waive compliance with the Franchise Investment Law.

The FAA only makes arbitration agreements as enforceable as other agreements. *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 511 (1974). It is firmly established that the right to contract is subject to the paramount authority of the state to safeguard the vital interests of its people. *Veix v. Sixth Ward Building & Loan Association*, 310 U.S. 32, 38-39 (1940). The authority of a state legislature in the exercise of its police powers cannot be limited or restricted by the provisions of private contracts between an individual and a corporation. *Dillingham v. McLaughlin*, 264 U.S. 370, 374 (1924). If the rule were to the contrary, the most im-

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[35] *Comprehensive Merch. Cat., Inc. v. Madison Sales Corp.*, 521 F.2d 1210 (7th Cir. 1975), *citing Moseley v. Electronic Facilities*, 374 U.S. 167 (1963); *Main v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 67 Cal.App.3d 19, 136 Cal.Rptr. 378 (1977).

[36] *See* Reply Brief to Answer to Petition for Hearing in the Cal. Supreme Court at 2-8.

portant and valuable reforms could be precluded by the simple device of entering into contracts for the purpose of doing that which was otherwise prohibited. *Louisville N.R. Company v. Motley,* 219 U.S. 467, 482 (1911).

If Southland's arbitration clause were upheld in the face of California's antiwaiver statute, it would be singled out for special sanction unavailable to any other provision or stipulation purporting to waive compliance with the Franchise Investment Law. The FAA by its terms does not require such a result, nor is the policy favoring arbitration furthered by allowing corporations to shield allegedly unlawful conduct from full judicial scrutiny. Indeed, Southland's strained interpretation of that Act to prohibit judicial enforcement of state franchise legislation raises serious constitutional questions.

E. The Federal Arbitration Act Would Be Unconstitutional If Applied to Bar State Courts from Adjudicating Important State Rights for which Access to a Judicial Forum Is Guaranteed by the State Legislature

The determination that the FAA does *not* preempt antiwaiver provisions in state legislation such as the California Franchise Investment Law is further compelled by the rule requiring that statutes be interpreted to avoid possible unconstitutionality. *Alabama State Federation of Labor v. McAdory,* 325 U.S. 450, 470 (1945). Southland contends that Congress has used a general procedural statute to confer upon private parties the power to veto state protective legislation. According to Southland, regardless of the state interest involved, Congress has declared that it is up to target corporations to decide whether their alleged unlawful practices are to be "muffl[ed] in the cloakroom of arbitration"[37] rather than subjected to public airing and full judicial scrutiny. As stated above, the history and purpose of the FAA support no such construction. Nonetheless, assuming arguendo that Congress did have such intent,

[37] *Merrill Lynch, Pierce, Fenner & Smith v. Ware,* 414 U.S. 117, 138 (1973).

this Court would have to declare such application of the Act to be unconstitutional.

In creating a private right of action as part of protective legislation, Congress relies on the judiciary as its sister branch to enforce the rights and remedies specified therein and thus vindicate the important congressional policy embodied in such legislation. *See, e.g., Alexander v. Gardner-Denver Co.*, 415 U.S. 36, 45 (1974); *Wilko v. Swan*, 346 U.S. 427, 436-437 (1953). Just as Article III, Section 1 of the Constitution confers the judicial power of the United States upon the federal courts, so Article 6, Section 1 of the California Constitution confers the judicial power of the State of California upon the state courts. Important federal rights are identified by Congress and this Court; important state rights are identified by state legislatures and state courts. The California Legislature likewise relies on its courts to adjudicate private rights of action which it has created to enforce important state concerns.

While state law generally must be subordinated to paramount legislation of national concerns, state control of purely state matters is supreme.[38] The procedure by which state rights may be enforced and wrongs remedied is also "peculiarly a subject of state regulation and control."[39] State courts are the only courts with unlimited jurisdiction over state claims. Under our federal system, the federal courts also may hear state claims if the requisites for diversity jurisdiction are met or if the state claims are pendent to federal claims. In both situations, the fed-

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[38]"Except in matters governed by the Federal Constitution or by Acts of Congress, the law to be applied in any case is the law of the State. And whether the law of the State shall be declared by its Legislature in a statute or by its highest court in a decision is not a matter of federal concern." *Erie R. Co. v. Tompkins*, 304 U.S. 64, 78 (1938).

[39]*Melancon v. McKeithen*, 345 F.Supp. 1025, 1044 (E.D.La. 1972), *aff'd. mem.*, 409 U.S. 943 (1972), 409 U.S. 1098 (1973), *quoting Hardware Dealers Mutual Fire Insurance Company v. Cladden*, 284 U.S. 151 (1931).

eral courts attempt to discern applicable state law, looking to the state supreme court for the final word on state issues,[40] sometimes staying the action in federal court pending resolution of crucial state issues by the state courts.[41]

These policies derive from principles of federalism grounded in the Constitution. *Erie R. Co. v. Tompkins,* 304 U.S. 64, 78 (1938). The Tenth Amendment imposes an affirmative constraint upon Congress' commerce powers. It ensures that the " 'separate and independent existence of the states' . . . not be lost through undue federal interference in certain core state functions." *Equal Employment Opportunity Commission v. Wyoming,* ..... U.S. ....., 103 S.Ct. 1054, 1060 (1983).

In contrast to that case, there is no issue here as to whether the state's police power has been preempted by a national legislative scheme developed in response to severe nationwide problems such as those created by discriminatory retirement practices. The state's power to enact legislation regulating the subject matter of franchise investments is conceded; it is solely the power to enforce such legislation which allegedly has been preempted.

Promoting arbitration of common law claims under the FAA provides relief to federal dockets by consensual removal of cases involving little or no public interest. This frees the federal courts to focus on enforcing important statutory and constitutional rights. Consistency is assured by having state courts apply the FAA to common law claims in interstate commerce. This construction of the Act is reasonable. But Southland contends that Congress went much further and relegated all state issues to arbitration regardless of their origin and importance. What federal interest is served by declaring that all state rights

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[40] *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ware,* 414 U.S. 117, 133 (1973).

[41] *See, e.g., American Airlines, Inc. v. Louisville & Jefferson C.A.B.,* 269 F.2d 811, 827 (6th Cir. 1959).

are adequately protected in an arbitral forum when Congress has found that forum unacceptable for important rights of its own creation?

Indeed, the choice of forum to adjudicate rights not created by Congress is generally not subject to Congress' power to regulate. Thus, in *Northern Pipeline Co. v. Marathon Pipe Line,* ..... U.S. ....., 102 S.Ct. 2858 (1982), this Court held unconstitutional Congress' grant of authority to bankruptcy courts to hear claims arising under state law. It held that congressional power to intrude upon the province of the constitutional courts is at "a minimum" when it seeks "to control the manner in which [a right under state law] is adjudicated." *Id.* at ....., 102 S.Ct. at 2878.

Compelling arbitration of state-created claims which are nonarbitrable under state law likewise appears beyond congressional power.[42] This designation of a body other than a constitutional court to hear and decide cases does not fit within proper categories of legislative courts recognized by the plurality in *Marathon.* Neither would such arrogation of judicial power survive the balancing test of the *Marathon* dissent. Like the appellants in *Marathon,* Southland provides no limiting principle. It threatens complete denial of access to state courts for adjudication of state-created rights whenever a private corporation engaged in interstate commerce chooses to insert an arbitration provision in its contract.

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[42]The constitutional question cannot be avoided by reference to the parties' agreement. The California Legislature defined the cause of action to survive any attempt to waive in advance the franchise investor's right to litigate in court. The parties' agreement by itself could not override this exercise of state police power. *See supra* at 32-33. Only the imprimatur of Congress could render the agreement preemptive of the legislative choice of forum.

Denial of the right of access to the courts for consideration of important rights also raises questions of due process. "Under certain circumstances, the constitutional requirement of due process is a requirement of judicial process." *Northern Pipeline Co. v. Marathon Pipe Line*, ... U.S. at ....., 102 S.Ct. at 2877 n. 33, *quoting Crowell v. Benson*, 285 U.S. 22, 87 (1932) (Brandeis, J., dissenting). Here, according to Southland, judicial process is preserved for important federal rights but not for important rights under state law. Such differential treatment is of questionable constitutionality. One of the decisive factors in *Marathon* was that Congress had vested the "adjunct" bankruptcy judges with powers over state-created rights far exceeding the powers it had vested in administrative agencies that adjudicate only rights of Congress' own creation. *Id.* at ....., 102 S.Ct. at 2878.

Congress' power under the Commerce Clause is, if anything, more circumscribed in controlling state court procedures than federal procedures. The control over state court dockets, including the right to a civil jury trial in the state courts, is not governed by the federal Constitution, but is a matter solely of state law and state concern. *Melancon v. McKeithen*, 345 F.Supp. 1025, 1036-1045 (E.D. La. 1972), *aff'd. mem.*, 409 U.S. 943 (1972), 409 U.S. 1098 (1973); *see U-Haul Co. v. Alabama State*, 294 Ala. 685, 316 So.2d 685 (1975) and *Butler v. Claxton*, 221 Ga. 620, 146 S.E.2d 763 (1966).

This analysis pinpoints the absurdity of Southland's contention. When Congress enacts protective legislation, it decides at that time whether the particular rights created require access to a judicial forum to assure their effectiveness. If so, predispute waiver of the right to a judicial forum is void. Only in the context of particular legislation can this determination be made. Yet Southland contends that Congress has utterly barred the states from ever making a similar determination regarding the enforcement of their own protective legislation wherever it touches upon inter-

state commerce. Any such blanket denial of access to state courts for vindication of important state policies would be beyond the authority delegated to Congress by the Constitution.

III

THE CALIFORNIA COURT'S DECISION TO CONSIDER CLASSWIDE ARBITRATION OF THE COMMON LAW CLAIMS DOES NOT IMPAIR ANY FEDERAL RIGHT

As discussed above, Southland had been litigating similar statutory and common law claims for two years in the California courts when the Keatings filed their class action. Before plaintiffs could move for class certification, Southland sought to compel arbitration, arguing that class proceedings were unavailable in an arbitral forum for lack of state legislative authorization.[43] The statutory claims have now been declared nonarbitrable as a matter of law. Thus, a class proceeding is contemplated in court in any event. One of the options available to the trial court is to send the common law claims to arbitration.[44] In such event, the California Supreme Court has authorized consideration of classwide arbitration of the common law claims, allowing Southland the option to litigate the entire action in court. Southland now argues that the exercise of that court's equitable powers is unconstitutional under the Supremacy Clause. It plainly is not.

A. The California Courts May Void the Arbitration Clause Altogether as Unconscionable Under General Principles of California Contract Law

The FAA ensures the validity and enforceability of arbitration agreements except ". . . upon such grounds as exist at law or in equity for the revocation of any contract."

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[43] *See supra* at 12-13 n. 8.

[44] *See* cases cited *supra* at 15 n. 12. The trial judge also has equitable jurisdiction to order the entire action to be adjudicated in court to avoid duplicative and bifurcated proceedings. *See* cases cited *supra* at 15 n. 11.

9 U.S.C. § 2. The initial question of validity is determined according to the applicable state law.[45] The Supreme Court of California has decided that there may exist "... grounds at law or in equity for the revocation ..." of the arbitration clause in Southland's standardized contracts of adhesion.

> It is common knowledge that arbitration clauses frequently appear in standardized contracts of adhesion. A primary consideration which has led courts to uphold such clauses, despite the adhesive nature of the contract, is the belief that arbitration is not oppressive and does not defeat the reasonable expectations of the parties. . . . If, however, an arbitration clause may be used to insulate the drafter of an adhesive contract from any form of class proceeding, effectively foreclosing many individual claims, it may well be oppressive and may defeat the expectations of the nondrafting party.

J.S.App. 25a (citations omitted).

The California Supreme Court was concerned with the twin specter of classwide wrongs going unredressed and the possibility of duplicative, individual arbitrations. Southland suggests that these concerns are without merit, but its supporting reasons merely emphasize the reasons why class actions were developed in the first place.

Southland asserts that there would be "[s]ubstantial economies," Op. Br. 40, if individual arbitrations should occur, but there is no way that many individual arbitrations can be handled as effectively and economically as one which determines all common claims. Absent a class or consolidated proceeding, there is no guarantee of consistency. There is no requirement that arbitrators give precedential weight to prior cases; nor can it be assumed that Southland would politely concur in an early finding of its liability so as to eliminate later arbitrations. Control over

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[45] *See supra* at 31.

how many times an issue had to be decided against it before it would concede the issue would reside with Southland, not the individual franchisees. But Southland considers numerous arbitrations unlikely. "[T]he true alternative to a class action in the instant litigation . . . is arbitration with a few claimants, not hundreds." Op. Br. 40. Precisely. This is why California considers the class action such an important remedial device. It prevents wrongdoers from retaining the benefits of their misconduct. *Fletcher v. Security Pacific National Bank,* 23 Cal.3d 442, 452, 153 Cal.Rptr. 28, 33, 591 P.2d 51, 57 (1979). The class action is often employed where a widespread practice injures large numbers of people but the amount of individual recovery would be insufficient to justify bringing an individual action.[46] It has been found particularly suited to the special circumstances arising, as here, from a standardized adhesion contract where the same provisions and practices apply to each member of the class.[47] The class action allows numerous individual claimants with no clout to command attention and redress.

The parties here are not equals—Southland has vastly superior bargaining power over each of the individual operators of its corner grocery stores. J.S.App. 6a. In *Ware,* this Court was also faced with an effort to defeat a class action by imposition of an arbitration provision in a similarly imbalanced setting. The unequal bargaining power of the nonunionized employee signing a standard form agreement to arbitrate was recognized as a strong state reason for voiding arbitration altogether as unfair. 414 U.S. 117, 131, 139 (1973). The same is true here.

In attempting to reconcile Southland's choice of arbitration with plaintiffs' right to pursue class relief, the California Supreme Court, if anything, erred in giving too

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[46] *Vasquez v. Superior Court,* 4 Cal.3d 800, 808, 94 Cal.Rptr. 796, 800, 484 P.2d 964, 968 (1971).

[47] *LaSala v. American Sav. & Loan Assn.,* 5 Cal.3d 864, 877, 97 Cal.Rptr. 849, 857, 489 P.2d 1113, 1121 (1971).

much weight to Southland's unilateral choice of arbitration.[48]

Rather than declare the arbitration clause completely invalid—which it might have done without impairing any right protected by the FAA—the California court remanded the case to the trial court to determine whether the inherent inequality and potential unfairness of arbitration in the setting of an adhesion contract could be cured by allowing class arbitration. The trial court was instructed to consider all available alternatives, including consolidation of arbitration proceedings.

There is nothing in that decision which even remotely threatens the liberal federal policy favoring arbitration. The California court did not invoke any contrary state policy. Actually, it leaned over backward to uphold the arbitration agreement in question.

B. State Courts Are Entitled to Apply Their Own Procedures in Enforcing A Right to Arbitrate Under the Federal Arbitration Act

This Court has long recognized that it does not have supervisory authority over state courts. Indeed, it has encouraged states to engage in procedural experimentation to meet changing social, economic and technological problems where no fundamental guarantees are infringed.[49] That principle is illustrated here.

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[48]Indeed, at least one state has chosen to void all arbitration clauses contained in contracts of adhesion. Iowa Code Ann. § 679A.1(2)(a) (West Supp. 1982).

[49]*Chandler v. Florida*, 449 U.S. 560 (1981), permitting television coverage in the courtroom in the face of a constitutional challenge: "[S]tates must be free to experiment. We are not empowered by the Constitution to oversee or harness state procedural experimentation; only when the state action infringes fundamental guarantees are we authorized to intervene . . . . In this setting, because this Court has no supervisory authority over state courts, our review is confined to whether there is a constitutional violation." *Id.* at 582-583; *See Johnson v. Louisiana*, 406 U.S. 356, 376 (1972) (Powell, J., concurring); *McKeiver v. Pennsylvania*, 403 U.S. 528, 547 (1971).

The FAA was envisioned as a statute governing federal court procedure.[50] Only section 2, declaring the validity, irrevocability and enforceability of agreements to arbitrate, embodies any national substantive principle. The remaining sections of the Act are primarily procedural in nature, governing stays (§ 3); the procedures to compel arbitration (§ 4); appointment of arbitrators (§ 5); form of applications to the court (§ 6); witness fees and appearances (§ 7); confirmation (§ 9); vacation (§ 10); correction of awards (§ 11); and motions relating thereto (§§ 12, 13). Several of these provisions, such as section 4, expressly rely on the Federal Rules of Civil Procedure to direct the manner of implementation, *e.g.*, service of the petition, request for jury trial. In addition, Federal Rule of Civil Procedure 81(a)(3) expressly makes the federal rules applicable to arbitration proceedings "to the extent that matters of procedure are not provided for in those statutes."

California has its own arbitration act, Cal. Civ. Proc. Code §§ 1280 *et seq.*, with substantive provisions nearly identical to section 2 of the FAA and with numerous procedural provisions on service, witness fees, motions and other incidents of such proceedings. The California courts apply the substantive principles of the FAA in appropriate cases, such as this one, but implement it with their own procedure. Indeed, that is what Southland invited the state courts to do here. *See supra* at 11-13 & nn. 7-8.

There is no basis—either in the history of the FAA or its interpretation by *any* court—to conclude that application of the Act requires a state court to replace state arbitration procedures with federal ones. To the contrary, the courts have uniformly recognized that in implementing section 2 of the Act, state courts apply their own procedure. *Moses H. Cone Memorial Hospital v. Mercury Constr. Corp.*,

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[50] *See* discussion *supra* at 22-23 & nn. 23-25.

..... U.S. ....., 103 S.Ct. 927, 942-43 & n.32 (1983);[51] *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*, 271 F.2d 402 (2d Cir. 1959); *Main v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 67 Cal.App.3d 19, 136 Cal.Rptr. 378 (1977); *Vigo Steamship Corp. v. Marship Corp.*, 26 N.Y.2d 157, 309 N.Y.S.2d 165, 257 N.E.2d 624, *cert. denied*, 400 U.S. 819 (1970). In *Vigo*, the New York court applied state procedural law to order consolidation of multi-party arbitration proceedings. The court considered, but rejected, the argument that federal law controlled the issue of consolidation. There is no theoretical reason why a class motion could not be considered by a state court followed by a classwide arbitration where such procedure otherwise appears superior to consolidation.

C. The Judiciary Has Always Played A Major Role in Structuring and Implementing Arbitration Procedures Under State and Federal Law

As the arbitration statutes themselves reveal, arbitration is not divorced from the courts; nor can it be. Although arbitration is invoked in the first instance by a private agreement, it relies on the courts for its enforcement. "Arbitration is not a separate proceeding independent of the courts, as was sometimes thought. The courts are brigaded with the arbitral tribunal in proceedings to compel arbitration or stay judicial trials, proceedings to enforce or

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[51]Southland's reliance on language in *Moses H. Cone Memorial Hospital* declaring section 2 of the Act a liberal federal policy favoring arbitration agreements notwithstanding any "state substantive or procedural policies to the contrary," ..... U.S. ....., 103 S.Ct. 927, 941 (1983), is misplaced. That declaration did not envision the substitution of federal procedural provisions for state procedures. It dealt solely with section 2 of the Act. The district court had stayed a petition to compel arbitration, deferring to parallel litigation in a state court involving the same issue of arbitrability. One of the reasons this Court reversed that order was because it was not clear that the state court in applying section 2 would have had available to it any procedure for compelling arbitration, such as is found in section 4 of the FAA.

quash subpoenas issued by arbitrators, . . . and proceedings to enforce or set aside arbitral awards." *Bigge Crane and Rigging Co. v. Docutel Corporation*, 371 F.Supp. 240, 246 (E.D.N.Y. 1973) (citations omitted). The federal courts have thus applied the Federal Rules of Civil Procedure to such matters as the service of a petition to compel arbitration,[52] motions to dismiss or for summary judgment,[53] pre-arbitration discovery,[54] and consolidation of multiparty arbitrations.[55] Consolidation of arbitration proceedings in federal court is authorized by the interaction of Rules 81(a)(3) and 42(a) where a dispute concerns several parties, each of whom has an agreement to arbitrate the dispute with one or more, but not all, of the others.[56] As the court in *Matter of Czarnikow-Rionda Co., Inc.*, 512 F.Supp. 1308 (S.D.N.Y. 1981), stated,

> Enforcement of an arbitration clause in federal court is controlled by the Federal Arbitration Act ("Act"), 9 U.S.C. §§ 1-14. Although the Act does not specifically provide for consolidated arbitrations, courts have fre-

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[52]9 U.S.C. § 4 specifically provides that the Federal Rules of Civil Procedure govern service of the petition. *See Hidrocarburos y Derivados, C.A. v. Lemos*, 453 F.Supp. 160, 165 n. 7 (S.D.N.Y. 1978).

[53]*Milwaukee Typo. U. v. Newspapers, Inc.*, 639 F.2d 386, 390 (7th Cir.), *cert. denied*, 454 U.S. 838 (1981).

[54]*See, e.g., Bigge Crane and Rigging Co. v. Docutel Corp.*, 371 F.Supp. 240, 244-46 (E.D.N.Y. 1973); *Ferro Union Corp. v. SS Ionic Coast*, 43 F.R.D. 11, 13-14 (S.D.Tex. 1967); *International Ass'n of Heat and Frost Insulators and Asbestos Workers v. Leona Lee Corp.*, 434 F.2d 192, 193-94 (5th Cir. 1970).

[55]*See, e.g., Compania Espanola de Pet., S.A. v. Nereus Ship.*, 527 F.2d 966, 974-75 (2d Cir. 1975), *cert. denied*, 426 U.S. 936 (1976); *Marine Trading Ltd. v. Ore. Intern. Corp.*, 432 F.Supp. 683, 684-85 (S.D.N.Y. 1977); *Robinson v. Warner*, 370 F.Supp. 828, 830-31 (D.R.I. 1974).

[56]Many state courts also authorize consolidated proceedings, *see* J.S.App. 27a, as do the Arbitration Rules of the New York Stock Exchange, *see, e.g.*, Rule 612(c)(1).

> quently ordered consolidated arbitration proceedings when the "interests of justice" so require either because the issues in dispute are substantially the same and/or because a substantial right might be prejudiced if separate arbitration proceedings are conducted.

Id. at 1309 (citations omitted).

Consolidation may involve an unlimited number of parties, each with its own version of the facts, claims or counterclaims for damages, defenses, and attendant battery of attorneys and witnesses, both percipient and expert. Because consolidation can involve several different arbitration clauses, the courts may mold the method of selection and number of arbitrators and resolve other conflicts among the agreements. *Id.* at 1309-10. "Thus, a party may be forced into a coordinated arbitration proceeding in a dispute with a party with whom he has no agreement, before an arbitrator he had no voice in selecting and by a procedure he did not agree to." J.S.App. 28a.

If by the interaction of Rules 81(a)(3) and 42(a), the federal courts can order consolidation, then by analogous reasoning it would seem that Rule 23, the class action rule, could form the basis for ordering class arbitration in an appropriate case. J.S.App. 26a-27a. Such will be for the federal courts to decide in controlling their own dockets.

The California Supreme Court, under its general equitable powers, has authorized consideration of a class arbitration procedure in the context of a standardized adhesion contract. The California Supreme Court directed the trial court upon remand to take into account any practical problems of class arbitration. It is premature to speculate how the trial court will resolve them. It is certainly improper to ask this Court to assume that the trial court will ignore the directive of the state supreme court to weigh all relevant factors before reaching a decision as to the viability of class arbitration.

D. Class Arbitration Is an Appropriate Experiment in Preserving Both Parties' Rights In the Context of an Adhesion Contract

Southland's argument that California has impaired the FAA merely by considering class arbitration requires Southland to prove that class arbitration is inconceivable under any circumstances under the FAA. It asks this Court to make such an absolute ruling despite the fact that there is no provision in the Act itself which bars such procedure and that the federal rules appear to permit it in an appropriate case.

There is simply no basis for this Court to declare that the class action and arbitration are inherently irreconcilable in their goals or implementation. Class actions are considered important by both the federal and state courts.[57] The class action promotes economical and efficient litigation by combining in one action common issues of fact and law, thereby preventing a multiplicity of actions. "Class actions serve an important function in our system of civil justice" by allowing vindication of small claims which might otherwise go unprosecuted because the result would be consumed by the cost. *Gulf Oil Co. v. Bernard*, 452 U.S. 89, 99 (1981). These small claims are of special concern to state courts since only those individual claims exceeding $10,000 are within federal diversity jurisdiction. *See Zahn v. International Paper Co.*, 414 U.S. 291 (1973).

Indeed, if upon remand Southland proves correct that there is a fundamental incompatibility between the procedures of arbitration and class actions,[58] Southland's arbi-

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[57] *General Telephone v. Falcon*, 457 U.S. 147 (1982); *American Pipe & Construction Co. v. Utah*, 414 U.S. 538, 551 (1974); J.S. App. 24a, *citing Richmond v. Dart Industries, Inc.*, 29 Cal.3d 462, 469, 174 Cal.Rptr. 515, 519, 629 P.2d 23, 27 (1981).

[58] Two state supreme courts have expressly approved a class arbitration, finding no incompatibility between arbitration and class action in an appropriate case. The Supreme Court of Georgia has approved combining a class action and arbitration in an adminis-

tration clause may well be declared invalid. But such a result seems unlikely. The supposed difficulties listed in Southland's "parade of horribles" are manageable without sacrificing any of the parties' essential rights.

i. The class certification motion with discovery, briefing and court hearing. These prearbitration proceedings need not consume lengthy amounts of time. The court has full power to control the timing and extent of discovery and is charged with proceeding to hear the class motion as soon as practicable after the filing of the action.[59] Discovery is not foreign to arbitration under the FAA; the federal courts order prearbitration discovery in appropriate circumstances.[60] These matters will not involve the court in all stages of the arbitration proceedings.

ii. Notice to the class. This presents no undue problems where the franchisees' addresses are in Southland's records. The form of notice and opt-outs are routine matters occurring only after the court determines that common issues exist and that they are suitable to resolution in one

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trative setting. In *Boynton v. Carswell*, 238 Ga. 417, 233 S.E.2d 185 (1977), *rev'd. on other grounds, Callaway v. Carswell*, 240 Ga. 579, 242 S.E.2d 103 (1978), taxpayers filed a class action in court protesting the reassessment of their properties. The court stated: "There is no legal or practical reason why this class controversy could not be settled in a class arbitration. The issue between each member of the class in these cases and the Joint Board of Assessors is identical . . . ." *Id.* at 582, 233 S.E.2d at 187. In *Stevenson v. Com. of Pennsylvania, Dept. of Revenue*, 489 Pa. 1, 413 A.2d 667 (1980), the court held that a class action was incorporated into the rules governing the arbitration proceedings before the administrative Board of Arbitration and Claims and that, accordingly, class actions were properly maintainable in the arbitrations. *Contra, Harris v. Shearson Hayden Stone, Inc.*, 82 A.D.2d 87, 441 N.Y.S.2d 70 (1981), *aff'd. mem.*, 56 N.Y.2d 627, 435 N.E.2d 1097, 450 N.Y.S. 2d 482 (1982). Southland itself recognizes that class actions and arbitration are not intrinsically incompatible. *See supra* at 12-13 n. 8.

[59]*City of San Jose v. Superior Court*, 12 Cal.3d 447, 453, 115 Cal. Rptr. 797, 801, 525 P.2d 701, 705 (1974).

[60]*See* cases cited *supra* at 44 n. 54.

arbitration. Notice in no way intrudes upon the arbitral process.

iii. Adequacy of class representative. Within the context of class actions, adequacy of representation primarily means that counsel for the class must be competent.[61] As to the individual class representative, there must be an initial determination at the time of certification that there is no conflict between the representative and the class.[62] Southland is not correct in suggesting that "adequacy" has to do with the day-to-day skill or diligence of the class representative or counsel, and that the court continually monitors these qualities in a class action trial, much like a foreman supervising his crew. That is not what "adequacy" means.

iv. The conditional nature of certification. Southland contends that because a class is only conditionally certified at the outset and may be decertified during the litigation, the court must exercise ongoing supervision, including review of the evidence at the arbitration. Under California law, however, decertification should occur only where changed circumstances exist; thus, the initial determination should rarely be upset.[63]

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[61] *Richmond v. Dart Industries, Inc.*, 29 Cal.3d 462, 478-79, 174 Cal.Rptr. 515, 525, 629 P.2d 23, 33 (1981); *Jordan v. County of Los Angeles*, 669 F.2d 1311, 1323 (9th Cir. 1982); *Lewis v. Curtis*, 671 F.2d 779, 788 (3d Cir. 1982); *Greenfield v. Villager Industries, Inc.*, 483 F.2d 824, 832 n. 9 (3d Cir. 1973).

[62] *McGhee v. Bank of America*, 60 Cal.App.3d 442, 450-51, 131 Cal.Rptr. 482, 488 (1976); *see Lewis v. Curtis*, 671 F.2d 779, 788 (3d Cir. 1982); *Senter v. General Motors Corp.*, 532 F.2d 511, 524-25 (6th Cir. 1976).

[63] *Green v. Obledo*, 29 Cal.3d 126, 172 Cal.Rptr. 206, 624 P.2d 256 (1981). By the use of a transcript, which is expressly provided for by the American Arbitration Association Rules of Commercial Arbitration, Rule 23, the court could review the proceedings, limited to the class certification issue, after the arbitrator completes the factfinding process. There would be no intrusion on the arbitration itself.

v. Other hypothetical objections by Southland to a class arbitration—supervision of any settlement, post-arbitration contests by intervening class members—likewise do not intrude upon the arbitration itself. Settlement discussions occur independently of—and often concurrently with—any arbitration proceeding. Post-arbitration attacks on an arbitration award are common and are always a matter for the courts. *See* 9 U.S.C. §§ 9, 10, 11; Cal. Civ. Proc. Code §§ 1285 *et seq.*

A class arbitration offers a speedier and more efficient resolution of claims than seriatim, duplicative arbitrations. Once liability on common claims is established, a procedure can be devised for determining the damages of each class member. Often hearings are not necessary. In this case, proof of damages will come largely from Southland's own accounting system. As to nondamage claims, the action seeks rescission, a remedy commonly held "manageable" in class actions.[44]

The class arbitration, being an untried procedure, will, of course, require ingenuity on the part of the courts. But Southland has not demonstrated that it is so inherently unworkable that it must be nipped in its first budding. As the California Supreme Court noted, the consolidated proceedings sanctioned by the federal courts and by California statute may much more greatly intrude upon the contractual aspects of the parties' agreement than would a class arbitration. J.S.App. 27a-28a. The class arbitration is really a two-party situation between the franchisor and representative franchisee. One determination of classwide disputes makes eminent sense especially where, as Southland states, the alternative to a class arbitration is a few scattered, individual arbitrations by which it would face only partial responsibility for any wrongdoing.

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[44]*See, e.g., Vasquez v. Superior Court*, 4 Cal.3d 800, 815, 94 Cal. Rptr. 796, 805, 484 P.2d 964, 973 (1971).

By concentrating solely on the asserted peril to arbitration posed by class proceedings, Southland hopes to divert this Court's attention from what really is at stake here. It is not arbitration which would be endangered by consideration of a class proceeding in an appropriate case, but class actions which would be virtually extinguished if arbitration could not accommodate them.

This Court is being asked to interpret the FAA as eliminating the class action device as a procedure for all claims encompassed by standardized contracts in interstate commerce. A corporation could insulate itself forever from liability for classwide wrongs merely by having the foresight to insert an arbitration clause in all of its forms.

The FAA was never intended to be used by parties of superior bargaining power to achieve such an unjust result. There is nothing in the nature or purpose of the Act which prevents a state in the exercise of its equitable powers over its own docket and procedures from neutralizing such an unfair tactic without disturbing the choice of forum.

CONCLUSION

For the reasons stated herein and in Appellees' Motion to Dismiss, this Court should dismiss this appeal for lack of jurisdiction or, in the alternative, affirm the decision of the California Supreme Court.

Respectfully submitted,

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No. 82-500

IN THE
Supreme Court of the United States
OCTOBER TERM, 1983

THE SOUTHLAND CORPORATION, *et al.*,
Appellants,

v.

RICHARD D. KEATING, *et al.*,
Appellees.

On Appeal from the Supreme Court of California

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REPLY BRIEF OF APPELLANTS

A. This Court Has Jurisdiction

1. *Appellees' Argument Concerning the Scope of the Parties' Arbitration Agreement Is Not Before the Court, and, in Any Event, Is Meritless*

Appellees contend that this Court lacks jurisdiction because the arbitration clause in the 7-Eleven franchise agreement allegedly is not broad enough to cover claims under the California Franchise Investment Law.[1] This

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[1] In this brief, "Appellees' Br." refers to the Brief of Appellees, "Appellants' Br." refers to the Brief of Appellants, "J.S. App." refers to the Appendix to the Jurisdictional Statement, and "J.A." refers to the Joint Appendix.

argument is not properly before the Court, for it was neither raised by appellees in the California Supreme Court nor considered by that court in its decision. The California Court of Appeal rejected appellees' argument concerning the scope of the arbitration clause (J.S. App. 65a-66a), and appellees elected not to challenge that ruling further.[2] Under California law, the point was deemed to have been abandoned.[3] Therefore, appellees are precluded from raising the issue anew in this Court.[4]

In any event, appellees' scope-of-the-arbitration-clause argument does not affect this Court's *jurisdiction* under 28 U.S.C. § 1257(2) (1976) to consider the issues raised in Southland's Jurisdictional Statement. At most, the issue goes to the *merits* of whether Southland is entitled to demand arbitration in this case. The authority cited by appellees in support of their "jurisdictional" argument, *Iowa Beef Packers, Inc.* v. *Thompson*, 405 U.S. 228 (1972) (per curiam), is not on point. In that case the Court dismissed a writ of certiorari, not because jurisdiction was lacking, but because the issue as to which the Court had granted discretionary review could not properly be addressed given the narrow scope of the

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[2] In the trial court, the judge had ruled *sua sponte* that the arbitration clause in the 7-Eleven franchise agreement was not broad enough to apply to statutory claims. The franchisees attempted to support that ruling in the California Court of Appeal, albeit on different grounds than they advance here. In this Court, appellees' argument is that arbitration is inappropriate because the franchise agreement does not require arbitration when "prohibited by applicable law" (*see* Appellees' Br. 6-11); this argument was not made by appellees in the California Court of Appeal. (*See* Respondents' Brief, Cal. Ct. App., June 4, 1979, at 17-22.)

[3] *See, e.g., Long* v. *California-Western States Life Ins. Co.*, 43 Cal. 2d 871, 279 P.2d 43, 50 (1955); *Title Guarantee & Trust Co.* v. *Fraternal Finance Co.*, 220 Cal. 362, 30 P.2d 515, 515 (1934). *See also* 6 B. Witkin, *California Procedure* § 425, at 4391-93 (2d ed. 1971).

[4] *See, e.g., Edelman* v. *California*, 344 U.S. 357, 358 (1953); *Hulbert* v. *City of Chicago*, 202 U.S. 275, 281 (1906).

parties' agreement to arbitrate. The arbitration clause in *Iowa Beef* was expressly limited to alleged violations of the agreement itself, whereas the grievance at issue pertained to an independent and separate claim under statutory law. There is no similar limitation on the face of the arbitration agreement now before the Court.[5]

In any event, the interpretation of the 7-Eleven arbitration clause being urged by appellees begs the question before the Court. Appellees point out that the agreement does not require arbitration where arbitration is "prohibited by applicable law," and they argue that the California Franchise Investment Law is the "applicable law." However, as appellees concede, the Federal Arbitration Act is also "applicable," and one of the ultimate issues to be decided by this Court is whether California can lawfully prohibit arbitration of claims where the federal statute applies. In other words, appellees are asking this Court, in the guise of a "jurisdictional" argument, to decide in their favor the underlying merits of this appeal. This would be contrary to this Court's longstanding rule that it determines the existence of jurisdiction *before* reaching the merits and not on the basis of who is correct as to the merits.[6]

Finally, appellees' narrow reading of the 7-Eleven arbitration clause is contrary to the policy of the Federal

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[5] Whereas the arbitration clause involved in *Iowa Beef* was limited to grievances " 'pertaining to a violation of the Agreement,' " 405 U.S. at 229-30, the 7-Eleven arbitration agreement covers all controversies "arising out of or relating to this Agreement or the breach hereof," except where arbitration is "prohibited by applicable law." (*See* J.S. App. 49a n.2.)

[6] *See, e.g., Hagans* v. *Lavine*, 415 U.S. 528, 542-43 & n.10 (1974); *Ex parte Watkins*, 32 U.S. (7 Pet.) 568, 572 (1833).

Appellees likewise beg the question before the Court when they argue that there is no federal question because state protective legislation—such as the California anti-arbitration law before the Court—"was never intended, and does not, fall within the coverage of the [Federal Arbitration] Act." (Appellees' Br. 17.)

Arbitration Act, which "requires a liberal reading of arbitration agreements," *Moses H. Cone Memorial Hospital* v. *Mercury Construction Corp.*, 103 S. Ct. 927, 941 n.27 (1983), and which "establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability." *Id.* at 941-42. *Accord, United Steelworkers* v. *Warrior & Gulf Navigation Co.*, 363 U.S. 574, 582-83 (1960). The agreement at issue in this case broadly calls for arbitration of *any* claim relating to the franchise relationship except to the extent that arbitration is *prohibited*. Where, as here, the exclusion clause is narrow and the arbitration clause quite broad, only the "most forceful evidence" of a specific exclusion of a particular claim will result in a decision that the claim is not within the scope of the arbitration clause. *United Steelworkers* v. *Warrior & Gulf Navigation Co.*, 363 U.S. at 584-85. There is no such evidence here.

2. *The Class Arbitration Issue Was Raised and Litigated in the California Courts*

Appellees claim that Southland did not raise the class arbitration question as a federal issue in the court below. (Appellees' Br. 11-13.)[7] Southland has already answered most of appellees' arguments concerning this claim. (*See* Appellants' Br. 21-23.)

Appellees contend that Southland conceded in the California Court of Appeal that state law, as opposed to federal law, controlled the class arbitration issue. (Appellees' Br. 12.) This is incorrect. The Clerk of the California Court of Appeal asked the parties to indicate

[7] Appellees do not contend that the other issue presented by this appeal was not raised and litigated below. (*See* Appellants' Br. 20 n.21.)

in their briefs whether Rules 23 and 81(a)(3) of the Federal Rules of Civil Procedure provided authority for ordering the arbitration to proceed as a class action.[8] Southland responded in the negative on the ground that Rule 81[9] only makes the Federal Rules applicable to judicial proceedings relating to arbitration (*e.g.*, suits to compel arbitration or suits to enforce an arbitral award) and does not make the Rules applicable to the arbitration itself (which would be the case if a court directed an arbitration to proceed as a class action under Rule 23).[10] Southland added in a footnote that, in any event, the Federal Rules of Civil Procedure are inapplicable in the state courts and that "California state courts normally apply their own procedural rules in *litigation* involving a federal substantive right, *provided that such application does not result in the violation of a federal right.*"[11] Southland also stated (i) that class action procedures would be inconsistent with the basic purposes and procedures of arbitration, (ii) that there was no authority for class action procedures under federal law, state law, or the rules of the American Arbitration Association, and (iii) that a class action arbitration would pose serious problems under the due process clause of the United States Constitution.[12] Southland reiterated

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[8] *See* Letter to Counsel from Office of the Clerk, Cal. Ct. App., May 18, 1979.

[9] Fed. R. Civ. P. 81(a)(3) provides, in pertinent part, that "[i]n proceedings under Title 9, U.S.C., relating to arbitration . . . , these rules only apply to the extent that matters of procedure are not provided for in those statutes."

[10] *See* [Southland's] Supplemental Memorandum of Points and Authorities in Opposition to Petition for Writs of Mandate or Prohibition, and Reply Brief, Cal. Ct. App., July 2, 1979, at 21.

[11] *Id.* at 21 n.15 (emphasis supplied).

[12] *Id.* at 16-25.

these points in the California Supreme Court.[13] Moreover, in both the Court of Appeal and the Supreme Court it was conceded by all parties that the Federal Arbitration Act was applicable.[14] Thus, it is wrong to suggest, as appellees do in their brief, that Southland conceded that the class arbitration issue was "governed by state law." (Appellees' Br. 12.)[15]

3. *The Decision Below Is a Final Judgment*

Appellees argue that there is no final judgment as to one of the two issues presented, namely the class arbitration issue.[16] They fail, however, to address the criteria set forth in *Cox Broadcasting Corp.* v. *Cohn*, 420 U.S. 469 (1975), and *Cohen* v. *Beneficial Industrial Loan Corp.*, 337 U.S. 541 (1949). They furthermore fail to acknowledge the cases exemplified by *Mercantile National Bank* v. *Langdeau*, 371 U.S. 555, 558 (1963), which hold that important questions concerning the proper forum for the resolution of a category of disputes can and should, in circumstances similar to those here, be reviewed by

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[13] *See* [Southland's] Petition for Hearing, Cal. S. Ct., Oct. 7, 1980, at 2, 6-22.

[14] *See* Petitioner's Supplemental Memorandum in re Arbitration in a Class Action, Cal. Ct. App., July 10, 1979, at 7; Petition for Hearing at 6 n.6. *See also* J.S. App. 4a-5a, 52a.

[15] In any event, even if Southland had failed in the state courts to present the class action issue as a broad federal question, this Court would nonetheless have jurisdiction to consider the issue now given the fact that "matters of basic principle are at stake." *See Lear, Inc.* v. *Adkins*, 395 U.S. 653, 662 n.10 (1969).

[16] Appellees virtually concede that there is a final judgment as to the California Franchise Investment Law issue. They did not challenge the finality of this issue in their Motion to Dismiss this appeal. (*See id.* at 5, 6-7.) Their only reference to this question in their brief on the merits is a bootstrap argument that this Court lacks jurisdiction because the Franchise Investment Law is not preempted by the Federal Arbitration Act. (*See* Appellees' Br. 17.) This "jurisdictional" argument is without merit. *See supra* note 6.

this Court prior to the completion of judicial proceedings. (*See* Appellants' Br. 16-17.)

Appellees' principal argument is that the ruling on the class arbitration issue is not "final" because Southland may yet be able to convince the trial court—after many additional months of class action discovery and briefing—to refrain from certifying a class in this particular case. (*See* Appellees' Br. 14.) As noted in Southland's opening brief, however, the delays and obstructions caused by judicial class action proceedings would themselves violate the policy of the Federal Arbitration Act—even if Southland were ultimately successful in those proceedings—since Southland would effectively lose the benefits of arbitration by being forced to engage in a lengthy, expensive, *judicial* procedure. (*See* Appellants' Br. 19-20.) Appellees' argument also overlooks the fact that the California Supreme Court's decision attempts to establish an important new rule of law that would not only affect this case, but arbitration generally. Thus, immediate review is warranted because, if Southland were to prevail in the further judicial proceedings, "there would remain in effect the unreviewed decision of the State Supreme Court" that class action arbitration proceedings may routinely go forward in the courts. *Cox Broadcasting Corp.* v. *Cohn*, 420 U.S. at 485.

Gillette Co. v. *Miner*, 103 S. Ct. 484 (1982) (per curiam), upon which appellees rely, is inapposite. The issue in *Gillette* was whether a class action in a state court must be limited to a statewide, as opposed to a nationwide, class. *See Miner* v. *Gillette Co.*, 87 Ill. 2d 7, 56 Ill. Dec. 886, 428 N.E.2d 478 (1981). This Court properly dismissed the petition for certiorari for lack of a final judgment since judicial procedures—indeed, judicial class action procedures—would go forward regardless of how the issue presented in the petition was resolved. The only question presented in *Gillette* concerned the *scope* of the class in an ongoing judicial

action, and any error in the state court's interlocutory ruling on that matter could easily be addressed at the conclusion of the litigation, without irreparably injuring the defendant's rights in the interim.

In the case at bar, the situation is quite different. The issue here does not concern the scope of a class in a proceeding that is destined to go forward in the courts in any event; rather, the question is whether judicial class action procedures should be available *at all* given "the unmistakably clear congressional purpose that the arbitration procedure . . . be speedy and not subject to delay and obstruction in the courts." [17] Moreover, failure to review now the California Supreme Court's ruling will mean the effective loss of the federal right of arbitration. There was no similar potential loss in *Gillette*.[18]

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[17] *Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404 (1967). *Accord, Moses H. Cone Memorial Hosp.* v. *Mercury Constr. Corp.*, 103 S. Ct. at 940 ("Congress's clear intent, in the Arbitration Act, [is] to move the parties to an arbitrable dispute out of court and into arbitration as quickly and easily as possible").

[18] Southland also pointed out in its opening brief that the California Supreme Court's disposition of the class action issue is appealable because that issue was decided in the procedural context of a separate proceeding for a writ of mandate or prohibition. (Appellants' Br. 18 & n.18.) Appellees dispute this, erroneously relying on *Runyan* v. *California*, 439 U.S. 904 (1978). (Appellees' Br. 16-17.) The reliance on *Runyan* is misplaced. This Court rendered no opinion in *Runyan*, and the Court's summary disposition of the appeal is of little precedential value in this Court. *See Edelman* v. *Jordan*, 415 U.S. 651, 671 (1974). There is no indication in *Runyan* that the Court intended to alter the "well settled" rule that a state court's final disposition of a writ of prohibition is a final judgment reviewable under 28 U.S.C. § 1257. *See Rescue Army* v. *Municipal Court*, 331 U.S. 549, 565-66 (1947).

Moreover, the issue in *Runyan* simply involved a question regarding pretrial discovery, and the judicial proceedings were going to continue in the trial court regardless of how the discovery issue was resolved by this Court. *See People* v. *Municipal Court* [*Runyan*], 20 Cal. 3d 523, 143 Cal. Rptr. 609, 574 P.2d 425 (1978). By contrast, the issue in the case at bar is whether the trial court has jurisdiction to conduct further judicial proceedings.

B. Where Interstate Commerce Is Involved, the Federal Arbitration Act Preempts State Legislation Purporting To Invalidate Arbitration Agreements

Most of appellees' arguments concerning the validity of the anti-arbitration provision in the California Franchise Investment Law are answered in Southland's opening brief. The following points, however, should be noted:

1. Appellees mischaracterize the issue when they colorfully state that enforcement of the parties' agreement to arbitrate would "destroy the effectiveness of California's . . . remedial legislation" (Appellees' Br. 18-19), "cripple the exercise of state police power in a substantive area" (*id.* at 19), and permit private parties "to veto state protective legislation." (*Id.* at 33.) Nothing in the 7-Eleven arbitration agreement purports to nullify any claims that appellees might have under the Franchise Investment Law; nor does the agreement provide for biased arbitrators or one-sided procedures. The agreement provides that the rules of the American Arbitration Association shall govern the arbitration (J.S. App. 49a n.2), and these procedures are universally recognized to provide for fair decisions by neutral arbitrators.

This case clearly does *not* involve any effort by Southland or by Congress to override the substantive protections of the California Franchise Investment Law. It only concerns the *forum* in which the parties must resolve their dispute. (*See also* J.S. App. 2a.) As the United States Court of Appeals for the Seventh Circuit recently recognized in rejecting an argument identical to the one advanced by appellees herein:

> [T]he conflict we face is plainly not one of federal arbitration procedures versus [state] substantive securities regulation. The conflict is rather between two *procedural* mandates . . . . If the Arbitration Act prevails, [state] substantive securities law remains intact . . . . [T]he real field of analysis here is the set of competing federal and state policies with

> respect to *non-legal dispute resolution*, not with respect to *securities regulation*.

Kroog v. *Mait*, No. 83-1094, slip op. at 10-11 (7th Cir. July 15, 1983) (emphasis in original).

2. Appellees are incorrect when they suggest that statutory claims are *ipso facto* inappropriate for arbitration. In the cases in which this Court has held that Congress has mandated the availability of a judicial forum, it has done so only after a careful analysis of congressional intent in the particular statute involved.[19] In *Wilko* v. *Swan*, this Court recognized that the Federal Arbitration Act could be a useful tool "both in controversies based on statutes or on standards otherwise created." 346 U.S. at 432. Similarly, in *U.S. Bulk Carriers, Inc.* v. *Arguelles*, 400 U.S. 351 (1971), five Justices of this Court recognized that arbitration is not necessarily inappropriate for resolving disputes based on federal remedial legislation. *See* 400 U.S. at 374 (White, J., dissenting, in an opinion in which Justices Brennan, Stewart and Marshall joined) ("Nor . . . has there been any principle that requires contract rights to be resolved internally but directs statutorily created remedies to be presented to the court, at least where, as here, the availability of the statutory remedy rests on disputed issues that are cognizable under the arbitration clause. In fact, this Court and lower federal courts have endorsed the suitability of arbitration to resolve federally created rights."); *id.* at 366 (Harlan, J., concurring). *See also Barrentine* v. *Arkansas-Best Freight System, Inc.*, 450 U.S. at 746-53 (Burger, C.J., dissenting, in an opinion in which Justice Rehnquist joined). Indeed, the Court has explicitly held that arbitration of federal statutory claims is appropriate in some contexts. *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506 (1974).

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[19] *See, e.g., Wilko* v. *Swan*, 346 U.S. 427 (1953); *Alexander* v. *Gardner-Denver Co.*, 415 U.S. 36 (1974); *Barrentine* v. *Arkansas-Best Freight System, Inc.*, 450 U.S. 728 (1981).

3. More fundamentally, the cases cited by appellees (Appellees' Br. 26 & n.28) involved a tension between the policies of two *federal* statutes, not, as here, a direct conflict between federal legislation and a state statute. In this situation, the *Wilko* v. *Swan* "analogy" is inapt, *e.g.*, *Kroog* v. *Mait*, *supra*, slip op. at 11-12, and the state statute must give way to the strong federal policy favoring arbitration, because the Federal Arbitration Act "creates a 'body of federal substantive law'" that prevails over "'any state substantive or procedural policies to the contrary.'" *Id.* at 9 n.4 (quoting *Moses H. Cone Memorial Hospital* v. *Mercury Construction Corp.*, 103 S. Ct. at 941). *Accord*, *Klein Sleep Products, Inc.* v. *Hillside Bedding Co.*, 563 F. Supp. 904, 906 & n.2 (S.D.N.Y. 1982), *motion for reconsideration denied*, Bus. Franch. Guide (CCH) ¶ 7941, at 13,503 (S.D.N.Y. 1983); *Marley* v. *Drexel Burnham Lambert, Inc.*, No. CA-3-79-1279-D, slip op. (N.D. Tex. July 7, 1983).

Appellees cannot avoid the preemptive effect of the Federal Arbitration Act by arguing that regulation of franchising is a matter of significant concern to the states. (*See* Appellees' Br. 19-22.) For example, even in the area of state regulation of mortgages, the Court has held that the normal principles of preemption "are not inapplicable . . . simply because real property law is a matter of special concern to the States: 'The relative importance to the State of its own law is not material when there is a conflict with a valid federal law, for the Framers of our Constitution provided that the federal law must prevail.'" *Fidelity Federal Savings & Loan Ass'n* v. *Cuesta*, 102 S. Ct. 3014, 3022 (1982) (quoting *Free* v. *Bland*, 369 U.S. 663, 666 (1962)). *Accord*, *Ridgway* v. *Ridgway*, 454 U.S. 46, 54-55 (1981) (domestic relations). *See also Brown* v. *Western Ry.*, 338 U.S. 294, 296, 298-99 (1949).[20]

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[20] Nor are the appellees correct in contending that "[w]hen the Federal Arbitration Act assertedly applies, the analysis should be the same" as when state courts exclude important state statutory

4. Southland noted in its opening brief that if appellees' position is sustained, the states will be free to undermine the Federal Arbitration Act by enacting a wide range of "exceptions" to the federal statute. (Appellants' Br. 29-30.) Appellees confirm the point in their brief. They argue that the reach of the Act should be narrowly limited to "common law" disputes and should be inapplicable whenever a state enacts a "statute" prohibiting arbitration of a category of disputes. (Appellees' Br. 22-31.) The Court should reject this proposal for several reasons:

(a) Appellees fail to cite anything in the Act, its legislative history, or in the case law to support the "common law versus statute" distinction, and there is, in fact, no such authority. *See Marley* v. *Drexel Burnham Lambert, Inc., supra*, slip op. at 4.

(b) Almost every subject matter, including torts and ordinary commercial relationships, can be the object of state remedial legislation. Thus, if the states could override the Federal Arbitration Act simply by enacting legislation dealing with a matter, the reach of the federal statute could be sharply curtailed by state legislatures and courts.[21]

(c) Appellees' argument is internally inconsistent. Fundamental state policies are not only embodied in statutes. They are contained in the common law as well, such that states have often recognized that the existing common law obviates the need for enacting a statute.

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claims from state arbitration acts. (Appellees' Br. 28.) State courts are free to interpret state statutes as they wish, but are obligated to follow and not impair any applicable federal statute. U.S. Const., art. VI, cl. 2. Since the Federal Arbitration Act clearly applies here, it takes priority over any competing state legislation.

[21] Some states, to this day, regard preexisting arbitration agreements to be contrary to public policy and unenforceable, notwithstanding the applicability of the Federal Arbitration Act. *See, e.g., Ex parte Alabama Oxygen Co.*, No. 82-106, slip op. (Ala. S. Ct. as amended June 20, 1983) (per curiam).

Therefore, if the purpose of appellees' proposal is to permit the states to ban arbitration when important policies are at stake, the logic of the argument would dictate that they be permitted to prohibit arbitration of common law disputes as well.

(d) To a large extent, state statutes merely reiterate common law remedies. Some states have adopted codes in which common law causes of action have been enacted into law by the legislature.[22] In addition, remedial statutes frequently are duplicative of, or are simply elaborations on, the common law. For example, in the instant case, appellees allege that Southland violated the Franchise Investment Law by intentionally making false statements and omissions in its franchise offering circular. (J.A. 17-19.) They allege that these exact same statements and omissions also constitute common law fraud. (*Id.* at 20.)[23] Where, as here, the statutory claim duplicates a common law remedy, there is no substance to the distinction that appellees propose.[24] Moreover, appellees' proposal would allow a plaintiff to evade his contractual obligation to arbitrate merely by asserting a redundant and essentially identical claim arising under the state's statutory law.

5. Appellees advance the following syllogism in their brief. The states are free to invalidate arbitration agreements "upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2 (1976). Under general doctrines of law and equity, unlawful

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[22] *See, e.g.*, Cal. Code Civ. Proc. §§ 25-30 (West 1982); Cal. Civ. Code § 3523 (West 1970). *See also id.* § 22.2 (West 1982).

[23] Actually, appellees' "common law" fraud claim is a *statutory* claim under California law. Cal. Civ. Code §§ 1571-73 (West 1982).

[24] This Court has explicitly held that arbitrators (even if they are not lawyers) are capable of deciding, and should decide, legal issues—such as fraud in the inducement—similar to the claims advanced by appellees in this case. *Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967).

agreements are unenforceable. Contracts requiring arbitration of Franchise Investment Law claims are unlawful. Therefore, Section 2 of the federal statute permits California to invalidate the arbitration agreement between appellants and appellees with respect to franchise claims. (*See* Appellees' Br. 31-32.)

Appellees' reasoning is faulty. Section 2 of the Federal Arbitration Act allows the states to refuse to enforce arbitration agreements on the basis of general principles of contract formation that are equally applicable to *all* contracts. But, where interstate commerce is involved, it does not permit them to single out arbitration agreements for special, restrictive treatment. *E.g.*, *Kroog* v. *Mait*, *supra*, slip op. at 9 n.4. In the case at bar, the state courts *rejected* all of appellees' general contract-formation arguments, such as "waiver" and "adhesion contract" (*see* J.S. App. 8a, 23a), and these rulings are not at issue in this Court. Here, appellees' argument is that the parties' arbitration contract is *inherently* unenforceable by virtue of a state statute, regardless of whether the agreement was knowingly and willingly executed by parties with legal capacity, and regardless of whether other general principles of contract formation were satisfied. Under Section 2 of the federal statute, the states are not free to invalidate arbitration agreements on this basis.[25]

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[25] *See* authorities cited in Appellants' Br. 24 & n.28, 26. This Court's decision in *Burks* v. *Lasker*, 441 U.S. 471 (1979), is also instructive. In *Burks*, federal regulation of investment companies and advisers was held to rely upon state corporate law. This Court nonetheless noted that "federal courts must be ever vigilant to insure that application of state law poses 'no significant threat to any identifiable federal policy or interest. . . .' And, of course, this means that 'unreasonable,' or 'specific aberrant or hostile state rules,' will not be applied." *Id.* at 479-80 (citations omitted). States must likewise conform their law to the Federal Arbitration Act, and California cannot evade the Act by relying upon its own "contract formation" principles.

6. Appellees state that the Federal Arbitration Act would be unconstitutional if it were interpreted to confer upon private parties "the power to veto state protective legislation." (Appellees' Br. 33-34.) This argument rests on a false premise because, as noted above, the federal statute merely relates to the forum for resolving a dispute and does not purport to nullify the underlying, state-created cause of action. *See Kroog* v. *Mait, supra*, slip op. at 10-11.

Appellees also seem to contend that it is unconstitutional for Congress to interfere with a state's control over the forum in which state-created rights may be enforced. (Appellees' Br. 34-38.) This argument was squarely rejected in *Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*, where the Court stated that the Federal Arbitration Act is based upon "the incontestable federal foundations of 'control over interstate commerce . . . .'" 388 U.S. at 405 (citations omitted).[26]

C. Class Action Arbitrations Would Be Inconsistent with the Federal Arbitration Act

1. *State Legislatures Cannot Declare Arbitration To Be "Unconscionable"* Per Se

Appellees suggest that Southland should not complain about the California court's decision to superimpose class action procedures onto the arbitration proceeding because, in the absence of such procedures, the entire arbitration agreement could have been struck down as "unconscionable." (*See* Appellees' Br. 38-41, 14 n.10.) They argue that such a decision would be consistent with Section 2 of the Federal Arbitration Act, which permits courts to invalidate an arbitration agreement "upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. This contention is untenable.

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[26] *See also National Mutual Ins. Co. v. Tidewater Transfer Co.*, 337 U.S. 582 (1949) (upholding constitutionality of diversity jurisdiction under 28 U.S.C. § 1332 as applied to state-created substantive rights).

Appellees have not identified any provision in the 7-Eleven arbitration agreement that is even arguably unconscionable as applied to their claims in this litigation. The contract provides for the selection of neutral arbitrators and specifies that the rules of the American Arbitration Association shall be followed. The arbitration proceedings in this case would proceed in the same manner as the thousands of other commercial arbitrations that take place each year.[27]

Appellees' "unconscionability" argument, which challenges the arbitral process itself rather than any particular defect in the agreement between the parties to this case, exceeds the narrow scope of the proviso in Section 2 of the Federal Arbitration Act. As this Court recently held in *Moses H. Cone Memorial Hospital*, courts must enforce arbitration agreements even though they might believe that some other procedure would be more efficient and equitable. *See* 103 S. Ct. at 939. (*See also* authorities cited in Appellants' Br. 40-41.) If judges were free to strike down arbitration clauses on the basis of the vague "fairness" principles that appellees propose, arbitration would be thrown back to the vagaries which existed before the federal statute was enacted and which it was the law's express purpose to remedy.

Appellees raise the spectre of unrighted wrongs in the absence of class action arbitration procedures. (Appellees' Br. 39.) However, as noted in Southland's opening brief, the appellees in this case have never alleged that they would be unable to prosecute their claims without a class action, and there is no objective evidence that

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[27] In 1981, the American Arbitration Association (AAA) handled 7,371 new commercial arbitrations alone; in 1982, the AAA dealt with 7,465 additional commercial cases. *1981-1982 Annual Report of the American Arb. Ass'n* 7; *1982-1983 Annual Report of the American Arb. Ass'n* 7. Arbitration by the AAA of other types of disputes is also extensive: in 1982 alone, the AAA processed 14,156 new accident-related arbitration claims and 17,038 labor-related claims. *Id.*

normal arbitration procedures have been inadequate in other cases. (*See* Appellants' Br. 39 n.52.) Moreover, appellees' argument overlooks the fact that arbitration *facilitates* the prosecution of small claims by providing a quick, informal, inexpensive alternative to costly court proceedings. (*Id.* at 39.)

2. *Class Action Arbitrations Would Substantially Impair the Federally Protected Right To Enforce Arbitration Agreements*

Appellees mischaracterize the issue when they describe the class action issue as a mere question of "procedure." (*See* Appellees' Br. 41-43.) Arbitration is a procedural device; but the Federal Arbitration Act goes beyond this and creates a substantive federal right protecting this procedure. Therefore, when a state attempts to alter that procedure by turning an informal, nonjudicial device into one that is complex and judicially controlled, the effect can only be described as a *substantive* interference with the federally protected right of arbitration.

It is true, of course, that the states can ordinarily apply their own procedures in their judicial proceedings relating to arbitration. (*See* Appellees' Br. 42-43.) For example, if a party files an action in state court to compel or to stay arbitration proceedings, the state court's normal rules regarding docketing fees, service of process, form of applications to the court, etc., will govern. However, the right to control *judicial proceedings* relating to arbitration does not create a license for the state courts to turn the arbitration itself into a judicially controlled procedure, for this would destroy the very essence of arbitration. This Court has often noted that state judicial procedures cannot be permitted to interfere with federal substantive rights.[28] And, with regard to arbitration in

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[28] *E.g.*, *Brown* v. *Western Ry.*, 338 U.S. at 296 (a "federal right cannot be defeated by the forms of local practice"), 299 (" 'the assertion of federal rights, when plainly and reasonably made, is not to be defeated under the name of local practice' ").

particular, this Court recently stated in *Moses H. Cone Memorial Hospital* that the states cannot interfere with the "liberal federal policy favoring arbitration" by the use of "any . . . substantive *or* procedural" policies. 103 S. Ct. at 941 (emphasis supplied).[29]

Notwithstanding appellees' feeble protestations to the contrary (*see* Appellees' Br. 46-49), it is beyond dispute that a "class action arbitration" would be radically different than a normal arbitration proceeding and would require substantial, ongoing, affirmative obligations on the part of a court. The procedure would be decidedly more formalized, time-consuming, expensive, and judicially controlled than arbitration as it now exists. (*See* Appellants' Br. 32-42.)[30] Indeed, given the added complexities that would be caused by the overlapping responsibilities of the

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[29] Appellees miss the mark when they attempt to analogize class action arbitrations to situations in which some lower courts have *consolidated* two separate arbitrations involving a common set of facts and three parties (*e.g.*, X initiates an arbitration with Y and Y files an arbitration demand against Z in a single contractual dispute). The propriety of such consolidations is unsettled. (J.S. App. 42a.) More importantly, consolidation merely brings several parties into one proceeding so that their mutually interdependent rights and liabilities can be adjudicated at one time. It did not appear in any of the cases cited by appellees (Appellees' Br. 44-45) that consolidation would increase the duration or cost of the proceeding, or pose manageability problems such as those presented by class actions, or interfere with the ability of the arbitrators to conduct the proceedings as they saw fit. The courts in those cases were able to make a clear-cut, one-time decision whether the arbitrations should go forth separately or together, and could thereafter divorce themselves from the conduct of the proceedings. Moreover, in the consolidation setting—unlike a class action—each party is personally represented rather than being forced to rely on the hope that someone else will adequately protect his interests.

[30] For instance, appellees are clearly wrong when they suggest that a class action would not require active judicial involvement. (Appellees' Br. 48.) Federal constitutional considerations of due process require careful judicial oversight at all stages of the proceedings. (*See* cases cited in Appellants' Br. 34-37.)

arbitrator and the court, it is difficult to imagine why parties would subject themselves to such a procedure. They would almost certainly opt for the "simpler" judicial class action, thereby circumventing the arbitration agreement as a direct result of the court-mandated procedures. We submit that this Court should not countenance such a result.

Respectfully submitted,

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1982

THE SOUTHLAND CORPORATION, et al.,
Appellants,

—vs.—

RICHARD D. KEATING, et al.,
Appellees.

MOTION FOR LEAVE TO FILE AMICUS CURIAE BRIEF OF THE STATE OF WASHINGTON SECURITIES DIVISION AND THE NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION

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The State of Washington Securities Division and the North American Securities Administrators Association, and its member states, joining in this motion request leave of this Court to file the attached Amicus Curiae brief in support of the right

of the individual states to legislate in the franchise area in order to prohibit franchisees from pre-dispute waiver of their right to a judicial forum. For the reasons set forth in the attached Amicus Curiae brief, and for the reasons set forth in the Statement of Interest contained in that brief, the State of Washington and the North American Securities Administrators Association and its member states, are concerned that the states' interests will not be adequately presented. This is inherent in the fact that the case involved private party litigants. The states' concerns include the many unregistered franchisees with no bargaining power and the larger question of the state's power to protect its citizens from powerful franchisors. This decision could undermine the ability of the state to see that its citizens have access to its state court where the state

law is more likely to be implemented properly. This decision could effectively cut off legitimate claims by franchisees in our state forced to travel thousands of miles to present their claims. We are vitally interested in an adequate system of dispute resolution within our state when a franchisor has reaped the benefits of selling his interests within the state.

The State of Washington and the North American Securities Administrators Association, and its member states make this motion because Southland Corporation has refused to consent to the filing of this Amicus Curiae brief.

Because the State of Washington's and the North American Securities Administrators Association's interest in this case is so significant, it respectfully files the

Motion for Leave to File the attached Amicus Curiae brief.

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**BRIEF OF AMICUS CURIAE
SECURITIES DIVISION
STATE OF WASHINGTON
AND THE
NORTH AMERICAN SECURITIES
ADMINISTRATORS ASSOCIATION**

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QUESTION PRESENTED

Whether the Federal Arbitration Act preempts a state franchise act that prohibits pre-dispute waiver of franchisee's right to sue in a court of law?

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§§ 1-14 (1976) . . . . . passim

Federal Exchange Act of 1934,
15 U.S.C. § 78a-7.8kk. (1981) . . . . . passim

Federal Securities Act of 1933,
15 U.S.C. §§ 77a-77aa (1981) . . . . . passim

Washington Franchise Investment
Protection Act, WASH. REV. CODE
§ 19.100 (1961 & 1982 Supp.) . . . . . passim

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WASH. REV. CODE § 19.100 (1978) . . . 19, 20, 21

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44 Fed. Reg. 49, 966 (1976) 28, 29

16 C.F.R. § 436.1(a)(24) (1979) 30, 31

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MISCELLANEOUS

Comment, The Franchise as a Security: Application of the Securities Laws to Owner-Operated Franchises, 11 B.C. Ind. & Com. L. Rev. 228 (1970) 9

15, G. Glickman, Business Organizations: Franchising, §3.03 - 3.03 [51] (1977) . . 8

Goodwin, Franchising on the Economy: The Franchise Agreement as a Security under Securities Acts, Including 10b-5 Considerations, 24 Bus. Law 1311 (1969) 9

Loss, Securities Regulation, (1961) . . . 11

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STATEMENT OF INTEREST

The Securities Division of the State of Washington, a division of the Department of Licensing, is the office mandated by the Legislature to regulate the offer and sale of securities, franchises, camp clubs and business opportunities in the state. It is a member of the North American Securities Administrators Association, a fifty state group whose aim is to establish national guidelines for securities and franchises which guidelines are later adopted through rulemaking in the various states. The State of Washington is one of thirty-eight states to have adopted the Uniform Securities Act drafted by Professor Louis Loss and adopted by the National Conference of Commissioners on Uniform State Laws. The Franchise Investment Protection Act of the State of Washington is based on both language, structure and purpose to the Uniform Securities Act.

In the instant matter the Washington State Securities Division is concerned with the outcome of this case because it substantially effects the numerous unregistered franchise agreements made in this state. We are concerned that Washington State citizens may be precluded from the protections of the Franchise Investment Protection Act, state police-power legislation, if the appellant's argument prevails. We are concerned that a franchisor, the party in the superior bargaining position, may be able to hide behind the Federal Arbitration Act and use it as a club to cut off the franchisees' rights under Washington law. Acceptance of Southland's arguments would interfere with the critical state interest and policy that Washington has in protecting its citizenry.

SUMMARY OF ARGUMENT

The franchise acts of various states including California contain the same or similar anti-waiver language to that of the Federal Securities Act of 1933, the Federal Exchange Act of 1934 and the Uniform Securities Act which has been adopted by thirty-eight states. The courts, including this court, have consistently held that language to void pre-dispute arbitration clauses. The various franchise acts throughout the country were promulgated for the same purposes as the securities acts, in order to provide sufficient information for the offeree to make an informed investment decision. Because of these similarities the franchise acts should be construed the same to void pre-dispute arbitration clauses.

Antitrust issues have also consistently been held to be nonarbitrable at both the state

and federal level. Many of these cases involve franchisees suing under the Federal Sherman Antitrust Act or one of the various state antitrust acts. In many states a violation of the franchise act is a per se violation of the state antitrust act. There is a parity of purpose behind these acts and there should be an agreement of construction.

Southland contends that a state statute barring arbitration in franchise agreements involving interstate commerce violates the Supremacy Clause of the United States Constitution. Specifically they contend that the Federal Arbitration Act supersedes the anti-arbitration policy of the California Franchise Investment Law. They rely on §2 of the Federal Arbitration Act which essentially provides that written arbitration provisions in contracts evidencing transactions in interstate commerce shall be "valid, irrevocable and enforceable". Section 2

actually goes on to provide that such provisions are valid, etc., "save upon such grounds as exist at law or equity for the revocation of any contract". There appears no indication whatsoever of congressional intent that agreements would be "valid, irrevocable and enforceable" solely by virtue of the Federal Arbitration Act. The purpose of the Federal Arbitration Act as pronounced by its authors was merely to overrule a long-standing judicial precedent against arbitration, not to totally preclude a state from legislating in this area.

The original purpose of arbitration was to speed up access to a decision making body, avoiding the delay and expense of litigation and to provide a more convenient forum to the aggrieved party. In this case none of these purposes would be met. Due to the expense and burden involved, it is unreasonable for the franchisees to pursue their remedy in a far

away location. There is a strong public policy of allowing the state to protect its citizens through legislation. If Southland's argument is accepted, the result will be that many legitimate claims will simply not be pursued.

ARGUMENT

I. SECURITIES ACTS, SIMILAR IN BOTH LANGUAGE AND PURPOSE TO FRANCHISE ACTS, PROHIBIT WAIVER OF JUDICIAL REMEDIES.

The Uniform Securities Act drafted by Professor Louis Loss of the Harvard School and adopted by the National Conference of Commissioners on Uniform State Laws is the model for the securities acts in thirty-eight (38) states. Both Federal and state securities laws were adopted for the general welfare and to protect the public from diversified methods of deceit and fraud in the sale of securities. Terril v. Hoyt, 149 Kan. 51, 87 P.2d 238 (1939); Howell v. First Boston International Corp., 34 N.E.2d 633 (1941); Goodyear v. Meux, 143 Tenn. 287, 228 S.W. 57 (1921); Merrill Lynch, Pierce, Fenner and Smith v. Ware, 414 U.S. 117 (1973).

This adoption was an exercise of the police powers of the state, not an infringement upon any personal or property right guaranteed by the constitution. State v. Simons, 193 Or. 274, 238 P.2d 247 (1951); Investment Reserve Corp. v. Michigan Securities Commission, 238 Mich. 606, 214 N.W. 311 (1927); King v. Commonwealth, 197 Ky. 128, 246 S.W. 162 (1922).

State legislatures in all but two states have enacted some form of franchise regulation. 15 G GLICKMAN, BUSINESS ORGANIZATIONS: FRANCHISING §3.03 - 3.03 [51] (1977). This is true even though "All franchise systems, however capitalized, are susceptible to securities regulation until such time as the franchise is so well established as a system that success or failure is not disproportionally keyed to the success or failure of the other franchises." 1969 Op. GA. Att'y. Gen. 661. See

also Goodwin, Franchising on the Economy: The Franchise Agreement as a Security under Securities Acts, Including 10b-5 Considerations, 24 BUS. LAW 1311 (1969); Comment, The Franchise as a Security: Application of the Securities Laws to Owner-Operated Franchises, 11 B.C. IND. & COM. L. REV. 228 (1970). However, the remedies provided under state securities laws proved to be inadequate for many franchises;[1] therefore, states adopted various franchise regulatory schemes to allay abuses suffered by naive franchise investors at the hands of over-zealous franchisors. "Blue sky" legislation continues to be potentially applicable to franchise offerings, in addition to state franchise legislation.

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[1]Mr. Steak, Inc. v. River City Steak, Inc., 324 F. Supp. 640 (D. Col. 1970) aff'd 460 F2d 666 (10th Cir 1972).

The Federal Securities Act of 1933 (15 U.S.C. §77n) and the Uniform Securities Act are very similar. Both are registration acts, and include similar sections granting exemptions from registration. Both have anti-fraud provisions that apply regardless of registration. Both give the regulators injunctive powers and investigative powers. Most important, both have anti-waiver clauses. See, 15 U.S.C. §77n and Uniform Securities Act §410(g). The anti-waiver section in the Uniform Securities Act was modeled on §77n of the Federal Securities Act of 1933, for the purpose of furthering the Federal-state coordination. The Federal anti-waiver clause, 15 U.S.C. §14 provides that "Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this title or of any rules and regulations of the Commission shall be void." The Uniform Securities Act §410(g) contains the same

language except that it refers to "this Act or any rule or order hereunder." As a matter of both policy and statutory construction the language of these anti-waiver provisions "in essence declares that an attempted waiver of the remedy under the Act is void." Merrill Lynch, Pierce, Fenner and Smith v. Moore, 590 F.2d 823, (10th Cir. 1970). In Wilko v. Swan, 346 U.S. 427 (1953) this court applied this reasoning directly to arbitration clauses and concluded that the right to select the judicial forum could not be waived under the anti-waiver language of §77n in the Federal Securities Act of 1933.

While §410(g) of the Uniform Securities Act is not applicable solely to arbitration clauses, it was intended to incorporate the holding of Wilko v. Swan, supra. As Loss, the author of the Uniform Securities Act explained in Loss, Securities Regulation, 1813-1814 (1961):

In 1953, the Supreme Court had to decide whether the non-waiver provisions in §14 of the 1933 Act invalidated a customer's margin agreement which provided that any controversy between him and the securities firm should be determined by arbitration . . . The Supreme Court had concluded that the right to select the judicial forum was the kind of "provision" that could not be waived under §14, because "it is clear that the Securities Act was drafted with an eye to the disadvantages under which buyers labor".

Clearly the draftsmen of the USA intended the anti-waiver language adopted to have the same effect on pre-dispute arbitration clauses as it does in the Federal Securities Act of 1933.

Courts have held that the language in the Federal Securities Act of 1934 likewise voids

pre-dispute arbitration clauses. Merrill Lynch, Pierce, Fenner & Smith v. Moore, 590 F.2d 823 (10th Cir., 1979). That court suggested that

> On this it is necessary to recognize that the policy consideration in the two instances with respect to the two remedies (referring to the Federal Securities Act of 1933 and the Federal Securities Act of 1934) are not different. The purpose of the Rule 10b-5 remedy is to protect the vulnerable purchasers of securities from the aggressive and more sophisticated seller (or buyer). Even though the arbitration proceeding may be faster and less costly to the public and, for that matter to the violator of the contract, the desirability of non-waiver of the remedy would prevail.

Id at 827.

The Third Circuit in Ayres v. Merrill Lynch, Pierce, Fenner & Smith, 538 F.2d 532 (3rd Cir., 1976), cert. denied, 429 U.S. 1010 (1976) was likewise not "persuaded that either the differences between the rights granted in the 1933 and 1934 Acts or any consideration of policy warrant such a distinction" between the 1933 and 1934 Acts. Id. at 536. See also, Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 558 F.2d 831 (7th Cir. 1977). Explaining that the purpose of the arbitration bar in the 1934 Act is to insure a complete and reviewable record of the proceedings, the court in Greater Continental Corporation v. Schecter, 422 F.2d 1100, 1103 (2nd Cir. 1970) likewise concluded that 1934 Act violations are "properly litigated in the courts." Congress intended, as did the draftsmen of the Uniform Securities Act, to assure that the purposes of the Securities Act of 1933 and 1934 would be carried out and that sellers would not be able

to maneuver buyers into weakened positions by forcing arbitration. State courts construing the same language from state acts have adopted the same view. See, Sandifer v. Reynolds Securities, Inc., 44 Co. App. 381, 618 P.2d 690 (1980); Sandifer v. District Court, 635 P.2d 547 (Colo. 1981); Kiehne v. Purdy, 309 N.W. 2d 61 (Minn. 1980).

The purpose of the state franchise acts, like that of the Uniform Securities Acts, is the protection of investors. The franchise acts of the various states were enacted "to correct franchise sales abuses such as the sale of franchises with the lack of material information and a lack of bargaining power on the part of the purchasers." Lobdell v. Sugar'N'Spice, 33 Wn.App. 881, 885, 658 P.2d 1267, 1271, (1983). A majority of the franchise law schemes are similar to the Uniform Securities Act and the Federal Securities Act of 1933. Like the

Federal Securities Act and the Uniform Securities Act, many franchise acts require registration, have exemptions from registration, and have anti-fraud provisions that apply regardless of registration.

> Modeled loosely on the new-issue provisions of federal securities and state blue-sky laws and closely on franchise-disclosure statutes in several other states, the act seeks to prevent fraudulent and unsound franchise promotions in Illinois by requiring the franchisor to give prospective franchisees extensive and verified written information . . ., on the background and resources of the franchisor and its principals, the terms of the franchise relationship, and the franchisor's prospects. My Pie Intern, Inc. v. Debould, Inc., 687 F.2d 919, 922 (7th Cir. 1982).

The regulators also have very similar injunction and investigatory powers under these acts. Twenty states have franchise acts with anti-waiver clauses. By using the same or similar language to that of the Federal Securities Acts of 1933 and 1934, the various state legislatures intended to reach the same results as in those Acts and their state counterparts; that is, they intended to protect their citizens and legislatively void waiver of important rights. Unfortunately, the courts have not always carried out this intent. See, Allison v. Medicab International, 92 Wn.2d 199, 597 P.2d 380 (1970); Barron v. Tastee Freeze International, 482 F.Supp. 1213 (E.D. Wis. 1980).

In Allison v. Medicab International Inc., supra, the court held the arbitration clause valid because they felt they had to rely on Pinkis v. Network Cinema Corporation, 9

Wn.App. 377, 512 P.2d 751 (1973). In Pinkis, similar issues had been raised but there had been no anti-waiver clause argument because the Washington Franchise statute became effective in 1972, two years after the date of the franchise agreement. The Pinkis decision was therefore only a contract case and not a statutory case. It involved a question of fraudulent inducement of the entire franchise contract. Allison, on the other hand, did deal with the Washington Franchise Investment Protection Act. The plaintiffs argued 1) the arbitration clause did not apply to statutory claims and 2) the Franchise Investment Protection Act prohibits enforcement of the arbitration clause. The real issue should have been the effect of the anti-waiver clause of RCW 19.100.180(g) upon the enforcement of the arbitration clause and the effect of the Federal Arbitration Act, 9 U.S.C. §1, et seq upon that. Because this important issue was not

discussed by the court, Allison does not stand for the position that a state through legislation can not protect its citizenry from the enforcement of a pre-dispute arbitration clause.

The court in Barron v. Tastee Freeze International, supra, relying heavily on Allison and Romnes v. Bache & Co., Inc., 439 F.Supp. 833 (W.D. Wis. 1977) came to a similar conclusion. The Barron court did consider the anti-waiver language and held that the Federal Arbitration Act applied, thereby nullifying Wisconsin's ability to legislatively void a pre-dispute arbitration clause. Examination of the briefs and transcript of oral argument (January 11, 1980, Case No. 79C-1025 U.S.D.C., Ed. Wis.) in Barron shows that neither party informed the court that no case presented to that court actually dealt with the issue of the impact of the Federal Arbitration Act upon state police power statutes, except

the Allison case. Neither party discussed the defects of the Allison decision. Neither party discussed the history or purpose of either the Federal Arbitration Act or the "anti-waiver" clause of the Wisconsin franchise laws. In Barron Judge Reynolds also relied on his own decision in Romnes as having dealt with the impact of the Federal Arbitration Act upon the "anti-waiver" clause although the Romnes decision clearly avoided that issue. In Romnes Judge Reynolds held that the case related solely to the Federal Commodities Exchange Act with the result that the claims were arbitrable because the Commodities Exchange Act has no "anti-waiver" provision. When the issue of how the same "anti-waiver" language effects the Federal Arbitration Act later came up again in the same Wisconsin District Court in Krogg v. Mait and Paine, Webber, Jackson and Curtis, Inc., F.Supp. (No. 82-C-0363, E.D. Wis., Jan. 7, 1983), Judge Warren, declining to follow

Judge Reynolds' reasoning in Barron, held that the Federal Arbitration Act does not preempt the "anti-waiver" clause of the Wisconsin Uniform Securities Act. That "anti-waiver" clause is substantially identical to the "anti-waiver" clause in the California Franchise Act now before this Court. Judge Warren noted that there is no clear mandate for preemption by the Federal Arbitration Act. He also noted that the state securities statute involves inherent police power, is remedial in nature, and presents a legislatively created cause of action, all of which is true of the case at bar. For the above reasons, neither Allison nor Barron should be viewed as providing cognizable legal reasoning as applicable to the case at bar.

Because this Court has consistently construed the exact language involved in the "anti-waiver" provision of California's franchise

act to nullify pre-dispute arbitration clauses in federal securities cases and the states have done likewise and because franchise acts are so similar in both structure and purpose to those acts, the language should be construed similarly to preclude the use of pre-dispute arbitration clauses.

II. ANTI-TRUST ACTS, SIMILAR IN PURPOSE TO FRANCHISE LEGISLATION, PROHIBIT WAIVER OF JUDICIAL REMEDIES.

A vast majority of the courts seem to agree that both Federal and state antitrust issues are not arbitrable. Wineland v. Marketex International, 28 Wn.App. 830, 627 P.2d (1981); United Nuclear Corporation v. General Atomic Company, 93 N.M. 105, 597 P.2d 290 (1979), cert. denied, 444 U.S. 911 (1979); Cobb v. Lewis, 488 F.2d 41 (5th Cir. 1974); American Safety Equipment v. J. P. Maguire

and Company, 391 F.2d 821 (2nd Cir. 1967); A & E Plastic Pak Co., Inc. v. Monsanto Company, 396 F.2d 710 (9th Cir. 1968). The reason this is so germane is that the purposes behind these statutes are similar to those of the franchise acts. In fact, many of these cases have involved franchisees who sued either under the Federal Sherman Antitrust Act, 15 U.S.C. §1, et seq., or one of the state antitrust acts. In many states a violation of the state franchise laws are also a per se violation of the state antitrust statute.

The purpose of the Sherman Antitrust Act was the "protection of a large segment of the public, frequently in an inferior bargaining position. The Sherman Act is designed to promote the national interest in a competitive economy; thus, the plaintiff asserting his rights under the act has been likened to a private attorney-general who protects the public's

interest." American Safety Equipment Corp. v. J. P. Maguire and Co., Inc, supra, at 826. Although that court notes that hundreds of thousands or -"perhaps millions"- of people can be affected in an antitrust case, the fact that not all the cases are that large does not affect the impact of these antitrust cases. Courts construing state antitrust acts have noted that policies underlying the Federal and state antitrust laws are concurrent. United Nuclear Corporation v. General Atomic Company, supra. In United Nuclear Corporation v. General Atomic Company, supra at 311 the court stated, regarding an integrated Federal-state antitrust policy, "The validity of these reasons does not vanish simply by exchanging the Federal judge for one in a state court who is charged with the same responsibility to enforce a strong public policy against monopolistic practices."

Along with the similarity of purpose behind Federal and state antitrust statutes, courts have also recognized the similarity of purpose of the Federal Trade Commission Act which regulates in the franchise area and the Sherman Antitrust Act. In Federal Trade Commission v. Raladam Co., 283 U.S. 643 (1930) the court discussing the Trade Commission Act, the Sherman Antitrust Act and the Clayton Act noted that "The object of the Trade Commission Act was to stop in their incipiency those methods of competition which fall within the meaning of the word 'unfair'. The great purpose of both statutes was to advance the public interest by securing fair opportunity for the play of the contending forces ordinarily engendered by an honest desire for gain." (citations omitted) Under the Federal Trade Commission Act if an arrangement constitutes a "franchise" within the meaning of the FTC rules, the offeror is required to make

disclosure irrespective of the absence of state legislation requiring such. 44 Fed. Reg. 49, 966 (1979). The regulations provide that if any state has protective legislation in the franchise area that is "equal to or greater than is provided by the rule" then it is consistent with the acts regulatory scheme. 16 C.F.R. §436.1(a)(24) (1979). No cases exist concerning whether claims charging violation of the Federal Trade Commission Act are proper subjects for arbitration because no private remedy exists under the Act. If it were to arise, the courts would respond that they were not proper subjects for arbitration, because of the policy interests served, by analogizing to such non-arbitrable antitrust enactments, both state and Federal.

The states which have enacted franchise legislation have declared a strong public for doing so. The Arkansas legislature while

promulgating the Arkansas Franchise Act declared that "distribution and sale of franchise agreements in the state of Arkansas vitally affects the general economy of the state, public interest and public welfare . . ." ARK. STAT. ANN. §13. In Shell Oil Co. v. Marinello, 63 N.J. 402, 307 A.2d 598, 602 (1973) the court noted that "Our Legislature in enacting the Franchise Practices Act, has declared that distribution and sales through franchise agreements in New Jersey vitally affect the general economy of the State, the public interest and the public welfare." Because of this widespread public effect and the similarities of purpose of the antitrust acts and franchise acts, if one is inappropriate for arbitration so is the other. In addition, it makes very little sense that, in those states which make it a violation of the state antitrust act to violate the franchise act, the arbitration clause would be enforceable under one act and void under the

other, even though the fact situation is identical.

III. THE HISTORY AND PURPOSE OF THE FEDERAL ARBITRATION ACT

Appellants argue that even though the purposes of the state antitrust and securities acts are the same as those of the Federal, the Federal Arbitration Act preempts state protective legislation. In American Airlines, Inc. v. Louisville & Jefferson County Air Board, 269 F.2d 811, 815, 816 (6th Cir. 1959) which did not deal with a state police-power statute, the court stated concerning the law of preemption that "Within the scope of the statute circumscribed by the Constitution, Federal law is of course paramount under the Supremacy Clause and State law must give way . . . Federal power to preempt being clear, it remains to inquire just how much of the field

the Congress intended and did occupy." (Emphasis added). The issue before the court in that case was the capacity of a quasi-governmental party to enter into the arbitration agreement, and therefore the validity of the clause. The court stated that the Federal Arbitration Act was passed "merely to overrule by legislation long-standing judicial precedent, which declared agreements to submit judicable controversies to arbitration contrary to public policy, . . ." and concluded that either Federal or state law may control the validity of an arbitration clause. Id. at 816. The operative provision of the Federal Arbitration Act with which the court was concerned was §2 which provides that:

> A written provision in any ** contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract ***

> or the refusal to perform the whole or any part thereof *** shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract. 9 U.S.C. §2, 61 Stat. 669 (1947).

The court stated:

> As to agreements to arbitrate which although evidencing transactions 'involving' commerce (U.S.C. §§1 and 2), are invalid, revocable or unenforceable under state or Federal law for other reasons, eg. fraud, lack of consideration or capacity or authority to contract, there appears no indication whatever of congressional intent that such agreements would be made valid, irrevocable and enforceable solely by virtue of the Federal Arbitration statute. And it is settled that ambiguous statutory

> language is not to be so read as to give it a reach beyond congressional intent as revealed inter alia by the legislative history, evil to be remedied, and object sought to be achieved.

Id. at 816

In the instant case, appellants argue that anti-waiver language directly conflicts with the Congressional declaration under §2 of the Federal Arbitration Act (Brief of Appellants Pg. 26) even though 1) the plain language of the statute indicates Congress recognized that there may be "grounds as exist at law or in equity for the revocation of any contract", and 2) the legislative history indicates otherwise. In Prima Paint Corporation v. Hood & Conklin, 388 U.S. 395 (1967), a case involving fraudulent inducement of a contract and not a Federal or state statute, Mr. Justice Black in

the dissenting opinion discussed the legislative history of the Federal Arbitration Act. Justice Black, construing that legislative history noted that state police-power acts preclude pre-dispute arbitration clauses.

In Moses H. Cone Memorial Hospital v. Mercury Construction Corporation, 51 U.S.L.W. 4156, 4162 (1983) the court discussing Prima Paint stated,

> The issue before us was whether the of fraud in the inducement was itself an arbitrable controversy. We held that the language and policies of [the Federal Arbitration] Act required the conclusion that the fraud issue was arbitrable.

Courts have agreed that if there is fraud involved in the inducement of the arbitration clause itself, the clause would be void. Robert

Lawrence Company v. Devonshire Fabrics, Inc., 271 F.2d 402 (1959), cert. denied, 364 U.S. 801 (1960); National Camera, Inc. v. Love, 644 P.2d 94 (Co.App. 1982). As in Prima Paint, Robert Lawrence involved only common law claims and not the effect of state police-power legislation upon the Federal Arbitration Act. That court concluded that there exist no grounds "at law or in equity" for the revocation of the contract. That is certainly not true of the instant case. The "anti-waiver" clause applicable in this statutory case provides the grounds "at law" to preclude the use of the pre-dispute arbitration clause.

Federal regulation of a field must not be deemed preemptive of state regulatory power absent persuasive reasons. Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132 rehearing den. 374 U.S. 858 (1963); Allen-Bradley Local No. 111, United Electrical,

Radio, and Machine Workers of America v. Wisconsin Employment Relations Board, 315 U.S. 740 (1942). Even then, when a state exercises its police powers to protect its citizens, and that exercise would be valid if not superceded by Federal action in the regulation of interstate commerce, Congress must clearly manifest its intention to preempt such. International Union, United Auto Workers, A.F. of L., Local 232 v. Wisconsin Employment Relations Board, 336 U.S. 245 (1949), rehearing den., 336 U.S. 970 (1949). As Chief Justice Lumbard noted in his concurring opinion in Metro Industrial Painting Corp. v. Terminal Construction Co., Inc., 287 F.2d 382 (2nd Cir. 1961), a case between two commercial firms of equal bargaining power, on the issue of whether a particular dispute was covered by an arbitration clause:

> . . . the legislative history of (the Act) reveals little awareness on the part of

> Congress that state law might be affected. . . Having no clear mandate from Congress the extent to which state statutes and decisions are to be superseded, we must be cautious in construing the act lest we excessively encroach upon the powers which Congressional policy, if not the Constitution, would reserve to the states." Id at 386.

In light of this lack of a clearly manifested Congressional intent to occupy the field and the attempt of the states through protective legislation to protect its citizenry and maintain their various constitutional rights such as the right to trial by jury, the Federal Arbitration Act should not be construed to preempt the state franchise acts containing the anti-waiver language pertaining to pre-dispute arbitration clauses.

IV. THE STATE HAS A STRONG POLICY TO PROTECT ITS CITIZENS FROM WAIVER OF REMEDIES

As a policy matter, considering the purposes for arbitration, the court should protect the right of the states to prescribe a forum for the citizenry when a foreign company seeks the privilege of selling its products within the state's boundaries. The original purpose of arbitration was to speed up access to a decision making body, thereby mitigating damages and allowing contracting parties to avoid, if they so chose, the "delay and expense" of litigation. American Airlines, Inc. v. Louisville and Jefferson County Air Board, supra, at 816. This original purpose is being turned inside out by exploitive franchisors. Besides merely selecting the forum, use of arbitration clause has the effect of chilling claims. Due to the expense and burden

involved, it is unreasonable for the franchisee to pursue his rights in a far away location. The result is that many legitimate claims are simply not pursued at all. Redress should be facilitated not hampered. When the franchisor avails himself of the privileges of selling his products in a certain state, where the franchisee is located and where all negotiations take place, particularly if the claim is relatively small and the franchisee is greatly disadvantaged in relative bargaining strength, it is simply not fair to compel resolution in a distant forum.

This issue surfaces when a franchisor elects to use an exemption from the registration provisions or violates the act by not registering the franchisee. It is outlandish that a franchisor could circumvent the requirements and force arbitration by violating the law.

Numerous courts argue that there is a strong public policy favoring arbitration. American Airlines, Inc. v. Louisville and Jefferson County Air Board, supra. Moses H. Cone Memorial Hospital v. Mercury Construction Corporation, supra. In Cone the court stated that § 2 of the Federal Arbitration Act "is a congressional declaration of a liberal federal policy favoring arbitration agreements; notwithstanding any state substantive or procedural policies to the contrary. (Emphasis added) Id. at 4162. There is a strong public policy of arbitration in general which is embodied in the Federal Arbitration Act but the policy of allowing the state to protect its citizens through legislation is also very important and in this case should prevail. The "anti-waiver" clause applicable in this statutory case provides the grounds "at law" to preclude the use of the pre-dispute arbitration clause. It was never intended that the Federal Arbitration Act would

operate to restrict the states' police powers and without clear intent on the part of Congress, it should not be so construed.

CONCLUSION

For all of the reasons stated above, the decision of the California Supreme Court concluding that the California legislature intended to render arbitration agreements unenforceable with respect to claims based upon that statute and that anti-arbitration statutes of that kind do not contravene the federal substantive law embodied in the Federal Arbitration Act should stand.

Respectfully submitted,

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No. 82-500-ASX
Status: GRANTED

Title: Southland Corporation, et al., Appellants
v.
Richard D. Keating, et al.

Docketed:
September 22, 1982

Court: Supreme Court of California

Counsel for appellant: Bleakley, Peter K.

Counsel for appellee: Van de Kamp, John, Wells, John F.

Entry	Date	Note	Proceedings and Orders
1	Sep 22 1982	G	Statement as to jurisdiction filed.
2	Aug 26 1982		Application for an extension of time to file a petition for certiorari and/or docket an appeal and order
3	Aug 26 1982		granting same until September 22, 1982 by Rehnquist, J., on August 30, 1982.
4	Sep 22 1982		Appendix of appellant Southland Corp., et al. filed.
6	Oct 8 1982		Order extending time to file response to jurisdictional statement until November 23, 1982.
7	Nov 24 1982		Motion of appellees Richard D. Keating, et al. to dismiss filed.
8	Dec 1 1982		DISTRIBUTED. January 7, 1983
9	Dec 3 1982	X	Reply brief of appellant Southland Corp., et al. filed.
10	Jan 10 1983		Further consideration of the question of jurisdiction is POSTPONED to the hearing of the case on the merits.
			**********
12	Feb 18 1983		Order extending time to file brief of appellant on the merits until March 10, 1983.
13	Mar 10 1983		Joint appendix filed.
14	Mar 10 1983		Brief of appellants Southland Corp., et al. filed.
15	Mar 18 1983		Record filed.
16	Mar 18 1983		Certified original record (BOX) received.
18	Apr 5 1983		Order extending time to file brief of appellee on the merits until May 9, 1983.
19	May 9 1983		Order further extending time to file brief of appellee on the merits until June 3, 1983.
20	Jun 6 1983		Brief of appellees Richard D. Keating, et al. filed.
22	Jun 6 1983	G	Motion of Securities Division of the State of Washington, et al. for leave to file a brief as amici curiae filed.
23	Jul 8 1983		CIRCULATED.
24	Aug 9 1983	X	Reply brief of appellants Southland Corp., et al. filed.
25	Aug 15 1983		SET FOR ARGUMENT. Tuesday, October 4, 1983. (3rd case)
26	Aug 23 1983		Motion of Securities Division of the State of Washington, et al. for leave to file a brief as amici curiae GRANTED.
27	Oct 4 1983		ARGUED.